VAJIRAM & RAVI

GENERAL STUDIES

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CHAPTER – 1

PLANNING AND GROWTH

The architect of Indian Planning was India's first Prime Minister Pandit Jawaharlal Nehru who conceived planning as a tool of economic and social development. While he had planning model of Soviet Russia as the basis of planning, there was also a realisation that development of Indian economy could not be left alone to the government and the public sector. Hence, planning model adopted in India was that of a mixed economy in which both public and private sectors would work hand in hand. Mixed economy as a model of economic development was adopted in 1948 even before the setting up of the Planning Commission in 1950. It was in 1951 that the first Five Year Plan was formulated on the basis of democratic planning under which both public and private sectc[illegible]'d work together.

l'd actinc [illegible] he State could play a significant role both in raising the rate of dom[illegible]mmes ar[illegible] well as investment. The Planning machinery could also mobilise id[illegible]ars the st[illegible]ating productive assets like infrastructure apart from achieving the pattern of [illegible]ocial justice.

and rur[illegible] role of public sector was to be overwhelming as this sector was expected to differ[illegible]r the major responsibility of growth, development, as well as social change with [illegible]acking of the State and the Planning Commission. Public Sector Enterprises were [illegible]scribed as temples of modern India. The dominance of public sector found expression in the form of Nehru-Mahlanobis model of heavy industries which was adopted in the Second Five Year Plan beginning in 1956. It was this model which was also expected to bring about socialist pattern of society through its trickle down impact, which implied that the fruits of development of heavy industries would trickle down to the masses to bring about socialistic pattern. These expectations of planners completely misfired as heavy industry model led to concentration of economic power in the hands of a few industrialists who cornered the fruits of development of these industries on the basis of licence and quota system and Inspector Raj. It also simultaneously led to the relative neglect of agriculture due to which there were acute food shortages throughout the sixties which led to the adoption of green revolution.

Although the model of planning was democratic planning, in actual practice it was centralised planning with predominance of the public sector. Contribution of the private sector was largely by way of licences and quotas which were cornered by a handful of industrialists, so that planning was in the form of 'planning by inducement.'

It was from 1992 that a definite shift took place in planning strategy from "Planning by Inducement" to "Indicative Planning" under which the private sector was expected to perform a much greater role than public sector. In other words, market forces of demand and supply were to play a much bigger role in all spheres of economic activity. It was felt that the process of planning and the pattern of government activities followed hitherto had dampened people's initiatives and their sense of responsibility towards building the nation. The process of planning, therefore, needed to be corrected in this respect and the role of planning as well as the Planning Commission needed to be redefined. The Eighth Five Year Plan 1992-97 was the first indicative planning model. This plan was prepared in the backdrop of economic reforms based on [illegible] Manmohan model which, inter alia, brought about large scale de-licensing of several [illegible] to do away with inspector raj. Globalisation and Privatisation had become key [illegible]nts throughout the world to push growth. The ideology of Thatcherism based on a[illegible] privatisation of major government enterprises in Britain under the leadership of Ma[illegible] Thatcher was delivering results. This prompted many countries to dilute the rol[illegible] government and incentivise private sector. It also saw the disintegration of th[illegible] communist world under the USSR.

However, throughout thereafter, Planning Commission in India continued to remain the principle policy formulation body. It was only after the 11th Five Year Plan that laud whispers were heard about the limitation of Planning Commission as the apex institution. As early as 2009, the then Prime Minister Dr. Manmohan Singh made a statement that the role of Planning Commission needs to be redefined and it should only continue to being a think tank somewhat like the Chinese model.

The Commission was seen by many as a lingering vestige of the country's attempt to replicate the Soviet model of a planned economy. Many observers felt that there were cases where in-principle approvals, investment clearances, grants-in-aid and other decisions appeared to smack of bureaucratic red tape as also visible vestiges of communal and control inspector raj mindset.

In this backdrop, it was decided in 2014 that the Planning Commission would be disbanded in favour of a new institution that better reflects the country's federal structure and copes with the emerging economic challenges. It was observed that the central government was no longer the fulcrum of economic development and states will have to be taken on the board as equal stakeholders. As such, there was a need to revive moribund forums like the National Development Council and Inter State Council to have a model of development driven by states and modelled on China's National Development and Reforms Commission.

Accordingly, a new body to replace the Planning Commission has been set up namely 'National Institute for Transforming India' or in brief NITI Aayog.

Setting up of this new body does not take away from the Planning Commission its immense contribution over 60 years of its functioning like evolving inclusive planning, rationalising centrally sponsored schemes, acting as spokesperson for States, encouraging decentralised planning, facilitating economic reforms (particularly after 1991) and acting as an independent evaluation machinery in terms of government programmes and their critique. Besides, the formulation of the 12th Five Year Plan clearly bears the stamp of the Planning Commission which adopted an altogether different pattern of preparing the plan by constituting working groups on public utilities like water and rural development as well as on Panchayati Raj headed by experts drawn from different organisations as well as from industry and research institutions.

The 21st century has seen most of the reforms in India led by the State Governments rather than the Centre. States like Gujarat, Madhya Pradesh, and Andhra Pradesh have introduced innovative schemes with far reaching impact on the welfare of the people. Even the concept of BIMARU States has been proved wrong by excellent and pioneering work of some of the States whose growth rates have been much higher than the national average.

In this regard, it must also be mentioned that the Planning Commission has played a significant role in streamlining, rationalising and reduction of centrally sponsored schemes through extensive consultations with States. This has resulted in taking over a major responsibility by States for such activities suited to their conditions. Guidelines for several centrally sponsored schemes have accordingly been modified by the Planning Commission to suit location specific designs and other conditions of

different states. Planning Commission has also been responsible in recent years for being spokesperson of States in increasing their royalty from minerals.

It is expected that the NITI Aayog will take over this role of the Planning Commission in earnest. Cooperative federalism being the main plank of centre's functioning, greater role is envisaged for the National Development Council set up in 1952 as a non-statutory body because it has representation of Chief Ministers of all States.

NITI Aayog has since started its work and its task force on agriculture has recommended big bang reforms to address the politically sensitive issue of frequent spurt in crop prices. These include guaranteed prices for at least half of the key crops, setting up of a unified national agriculture market, changing land lease laws and creating a mechanism to facilitate easy exit for farmers who want to move out of agriculture. The comprehensive report prepared in this regard talks about the need to address issues of bad weather, fluctuation in crop prices and demand and supply problems.

The Aayog has also taken over the appraisal of the ambitious high-speed railway network.

The Twelfth Five Year Plan (2012-17) prepared under the UPA Government lays down a GDP growth target of 8 per cent with its theme of faster, sustainable and more inclusive growth. It lays down 25 indicators for this pattern of growth. Major highlights of the Plan are as follows:

I. Growth Rates

GDP 8.2 percent, Agriculture 4 per cent, Manufacturing 7 per cent, Industry 7.6 per cent and Services 9 percent.

II. Poverty and Employment

Head-count ratio of consumption poverty to be reduced by 10 percentage points over the preceding estimates by the end of Twelfth Five Year Plan. Generate 50 million new work opportunities in the non-farm sector and provide skill certification to equivalent numbers during the Twelfth Five Year Plan.

III. Education

(a) Mean Years of Schooling to increase to seven years by the end of Twelfth Five Year Plan.

(b) Enhance access to higher education by creating two million additional seats for each age cohort aligned to the skill needs of the economy.

(c) Eliminate gender and social gap in school enrolment (that is, between girls and boys, and between SCs, STs, Muslims and the rest of the population) by the end of Twelfth Five Year Plan.

IV. Health

(a) Reduce IMR to 25 and MMR to 1 per 1000 live births, and improve Child Sex Ratio (0-6 years) to 950 by the end of the Twelfth Five Year Plan.

(b) Reduce Total Fertility Rate to 2.1 by the end of Twelfth Five Year Plan.

(c) Reduce under-nutrition among children aged 0-3 years to half of the NFHS-3 levels by the end of Twelfth Five Year Plan.

V. Infrastructure, including Rural Infrastructure

(a) Increase investment in infrastructure as a percentage of GDP to 9 percent by the end of Twelfth Five Year Plan.

(b) Increase the Gross Irrigated Area from 90 million hectare to 103 million hectare by the end of Twelfth Five Year Plan.

(c) Provide electricity to all villages and reduce AT&C losses to 20 percent by the end of Twelfth Five Year Plan.

(d) Connect all villages with all weather roads by the end of Twelfth Five Year Plan.

(e) Increase rural tele-density to 70 percent by the end of Twelfth Five Year Plan.

(f) Ensure 50 percent and rural population has access to 55 LPCD piped drinking water supply and 50 percent of gram panchayats achieve the Nirmal Gram Status by the end of Twelfth Five Year Plan.

VI. Environment and Sustainability

(a) Increase green cover (as measured by satellite imagery) by 1 million hectare every year during the Twelfth Five Year Plan.

(b) Add 30000 MW of renewable energy capacity in the Twelfth Plan.

(c) Reduce emission intensity of GDP in line with the target of 20 percent to 25 percent reduction by 2020 over 2005 levels.

VII. Service Delivery

(a) Provide access to banking services to 90 percent Indian house-holds by the end of Twelfth Five Year Plan.

(b) Major subsidies and welfare related beneficiary payments to be shifted to direct cash transfer by the end of the Twelfth Plan, using the Aadhar platform with linked bank accounts.

The Plan identifies twelve core areas that require fresh approach to produce the desired results. These are: Enhancing capacity for higher GDP growth, enhancing skills and faster generation of employment, managing environment, well regulated markets, land, labour, capital and goods, decentralisation and empowerment, Technology and innovation, Secure Energy future for India, Accelerated development of transport infrastructure, Rural Transformation and Sustainable agriculture, Managing urbanisation, Better prevention and curative health care and improved access to quality education.

INVESTMENT MODELS

Economic growth and development poses various challenges to policy makers to adopt a strategy which fulfils not only the aspirations of people but also ensures long term, sustainable growth to encompass all the sectors of the economy. In this regard, the choice of an appropriate investment model becomes paramount. India's planned growth since the Second Five Year Plan (1956-61) was based on an investment model called the Nehru-Mahalnobis model which was a four-sector model version of the two-sector Harrod-Domar model.

Many investment models have been put forward by various economists after the Second World War which can address growth aspirations of a majority of developing economies which got freedom after the war. A list of some prominent models is given below:

(i) Lewis model of development with surplus labour.

(ii) Harrod-Domar model based on experiences of advanced economies.

(iii) Public Private Partnership model – mainly to meet the demand for infrastructure.

(iv) BOT models – based on Build, Operate, Transfer/Build Operate Lease Transfer, or Build Own Operate Transfer.

(v) Private Finance Initiative model based on the responsibility of private sector to design construct and operate an infrastructure facility.

(vi) Foreign Direct Investment including FDI in green field investment and brown-field investment.

(vii) Foreign Portfolio Investment.

Performance of the Indian economy has been lacklustre in the last few years due to both domestic and global factors. On domestic front the economy has been in the grip of what Economic Survey 2014-15 calls macroeconomic vulnerability expressed by "Macro Economic Vulnerability Index" which comprises three variables viz., fiscal deficit, inflation and current account deficit. The first two are on the domestic front while the third one is on the external front of balance of payments. However, conditions have radically changed in 2015 during which both inflation and current account deficit have come down to much below the critical level. Yet, performance of the economy has not been up to the mark as global factors like slowdown in the eurozone and more importantly the recent slowdown in China are a cause of serious concern.

CHAPTER – 2

AGRICULTURE

According to the new series of national income released by the CSO at 2011-12 prices, the share of agriculture in total GDP was 18 per cent in 2013-14. Performance of agriculture in the Twelfth Plan has been below the targeted level of 4 per cent so far. The growth rate of agriculture in the first year of the Plan (2012-13) was 1.2 per cent at 2011-12 prices, 3.7 per cent in 2013-14 and 1.1 per cent in 2014-15. However, foodgrains production estimated for 2014-15 was 257 million tonnes compared to 266 million tonnes in 2013-14 and 257 million tonnes in 2012-13. Decline in foodgrains production in 2014-15 has been on account of lower production of rice, coarse grains, cereals and pulses due to erratic rainfall conditions.

However, a notable feature in this regard has been that from a food deficit economy for many years, India has turned into a food surplus economy in recent years due to various factors like increase in net sown area, use of High Yielding Variety (HYV) seeds, expansion of irrigation facilities, use of improved farm implements, use of MSP for various crops, better technology for pest management, etc. The agriculture sector has registered an annual growth of 3.8 per cent in the value added in the decade since 2004-05 on the back of an increase in real prices at the rate of 3.1 per cent average annual from 2004-05 to 2011-12. During this period, terms of trade between agriculture and non-agriculture have also become favourable for agriculture.

A major challenge is to reverse the deceleration that has taken place in agricultural growth rate in the first three years of the 12th Plan. There have been rising cases and incidence of farmers suicides due to lack of credit at affordable rates, falling global commodity prices, high prices of inputs and relative neglect of agriculture which has resulted in low productivity and rising indebtedness. To improve resilience of agriculture and bolster food security, including availability and affordable access, the strategy for agriculture has to focus on improving yield and productivity. There is a huge gap in yields vis-à-vis other countries and even within different states showing that there are possibilities of raising production by increasing yield without necessarily increasing prices.

An inverse relationship is noticed between increase in yield over time and the average cost of production of various crops in real terms. This clearly points towards the fact that productivity increases, especially in low productivity states can significantly contribute towards reducing cost-push food inflation. A yield is contingent upon several factors like variety and quality of seeds, soil quality, irrigation – including quality of water – fertilisers – including their proportion – pesticides, labour and extension services. Prices received by farmers and the certainty or assurance of getting a particular price also incentivise farmers to take to a particular crop and use quality inputs in its cultivation. The status of some of these factors in India is described in the following paragraphs.

Agricultural Research and Education

The Indian Council of Agricultural Research is engaged in developing new crop varieties with specific traits that improve yield and nutritional quality along with tolerance/resistance to various biotic and abiotic stresses. Besides, it matches crop production and protection technologies to target agro-ecologies. A total of 104 varieties of different crops were released for different agro-ecological niches. To ensure effective seed chain for making quality seed available to farmers, 11,835 tonnes of breeder seeds of recommended varieties of different field crops were developed. The adoption of improved varieties and crop management technologies has resulted in enhancement of production and productivity of cereals, pulses, and other field crops.

While greater outlay on applied research, education, and extension will result in more assured outcome in terms of reduction in average cost and increase in average yield/productivity, and growth, the paradigm shift in yield/productivity required for the second green revolution can be achieved, with greater outlay on basic research by creating research institutions on the pattern of Indian Institutes of Technology (IIT) and Indian Institutes of Sciences (IIS). It is imperative to make Indian agricultural growth science-led by shedding 'technology fatigue'. Budget 2014-15 provided for the establishment of two institutes of excellence in Assam and Jharkhand.

Agricultural Extension

The NSSO 70th round survey indicates that about 59 per cent of farmers do not get much technical assistance and know-how from government-funded farm research institutes or extension services. So they have to rely on progressive farmers, media, and

private commercial agents such as dealers of farm inputs like seeds, fertilisers, and pesticides for technical information. To ensure last-mile connectivity, extension services need to be geared up to address emerging technological and information needs. Effectiveness of the lab-to-farm programme can be improved by leveraging information technology and e- and mobile (m-) applications, participation of professional NGOs, etc. The Budget 2014-15 allocation of Rs.100 crore to Kisan TV for disseminating real-time information to farmers regarding new farming techniques, water conservation, organic farming, etc. will partly make up for the existing adverse ratio of one extension worker for every 800 to 1000 farmers and provide farmers a direct interface with agricultural experts.

Irrigation

The central government initiated the Accelerated Irrigation Benefit Programme (AIBP) in 1996-97 for the completion of incomplete irrigation schemes. An irrigation potential of 85.03 lakh ha is reported to have been created under the AIBP by states from major/medium/minor irrigation projects till March 2013. The Command Area Development Programme has also been amalgamated with the AIBP to reduce the gap between irrigation potential that has been created and that is utilised. Suggestions for a National Water Grid for transferring water from water surplus to water deficit areas have been made from time to time. In spite of these schemes, Indian agriculture is still heavily rainfall-dependent with just 35 per cent of total arable area being irrigated, and distribution of irrigation across states is highly skewed. Focus on micro-irrigation systems like drips and sprinklers would significantly increase water-use efficiency and productivity. The wide gap between gross cropped area and gross irrigated area which has not improved much since the First Five Year Plan period needs to be bridged for increasing productivity, production, and resilience.

Seeds

Seed is the basic input for enhancing agricultural production and productivity. Efficacy of all other agricultural inputs such as fertilisers, pesticides, and irrigation as well as impact of agro-climatic conditions is largely determined by the quality of the seed used. It is estimated that the quality of seed accounts for 20-25 per cent of agricultural productivity. During 2014-15, there has been shortfall in the availability of certified/quality gram, lentil, pea, soyabean, and potato seeds. Given our import dependence on oils and pulses and susceptibility of potato to inflation, steps are necessary to avoid shortages of

certified seeds of these commodities. Given the lack of evidence on negative consequences from Bt and other genetically modified (GM) crops, and the significant potential productivity, food security, and sustainability benefits, the corresponding regulatory frameworks and their implementation deserve rethinking.

Fertilisers

The following major initiatives were taken in the fertiliser policy of the government in 2014-15: (i) Notification of the Modified New Pricing Scheme (NPS-III) for existing urea units on 2 April 2014 in order to address the issue of under-recoveries of the existing urea units on account of freezing of fixed cost at the 2002-03 level. The modified policy has been implemented for a period of one year from the date of notification. (ii) Further, the government had notified the New Investment Policy 2012 on 2 January 2013 to facilitate fresh investment in the urea sector to make India self-sufficient.

Credit

The following measures have been taken for improving agricultural credit flow and bringing down the rate of interest on farm loans: (i) Agricultural credit flow target (ii) Farmers have been availing of crop loans up to a principal amount of Rs.3,00,000 at 7 per cent rate of interest. The effective rate of interest for farmers who promptly repay their loans is 4 per cent per annum during 2014-15. (iii) In order to discourage distress sale of crops by farmers, the benefit of interest subvention has been made available to small and marginal farmers having Kisan Credit Cards for a further period of up to six months (post-harvest) against negotiable warehouse receipts (NWRs) at the same rate as available to crop loan. Other farmers have been granted post-harvest loans against NWRs at the commercial rates. (iv) From 2014-15, in order to provide relief to farmers on occurrence of natural calamities, interest subvention of 2 per cent will continue to be available to banks for the first year on the restructured loan amount on account of natural calamities and such restructured loans will attract normal rate of interest from the second year onwards as per the policy laid down by RBI.

The Interest Subvention Scheme for short-term production credit (crop loans) which was started by the Government of India in 2006-07 was extended to private-sector banks from 2013-14. Presently the total number of loan accounts stands at 5.72 crore. Studies conducted by the RBI and National Bank for Agriculture and Rural Development (NABARD) indicate that the crop loans are not reaching intended beneficiaries and there

are no systems and procedures in place at several bank branches to monitor the end-use of funds. Also, although overall credit flow to the agricultural sector has increased over the years, the share of long-term credit in agriculture or investment credit declined from 55 per cent in 2006-07 to 39 per cent in 2011-12. According to NSSO 70th round data, as much as 40 per cent of the finances of farmers still comes from informal sources, despite an increase in the flow of institutional credit to agriculture in recent years. Usurious money lenders account for a 26 per cent share of total agricultural credit.

Inadequate targeting of beneficiaries and monitoring/ supervision of the end-use of short-term crop loans for which interest subvention scheme is applicable and decline in long-term/investment credit to agriculture are issues that need to be addressed on priority basis.

Mechanisation

Agricultural mechanisation increases productivity of land and labour by meeting timeliness of farm operations and increases work output per unit time. Besides its paramount contribution to the multiple cropping and diversification of agriculture, mechanisation also enables efficient utilisation of inputs such as seeds, fertilisers, and irrigation water. Although India is one of the top countries in agricultural production, the current level of farm mechanisation, which varies across states, averages around 40 per cent as against more than 90 per cent in developed countries. Farm mechanisation in India has been growing at a rate of less than 5 per cent in the last two decades. The main challenges to farm mechanisation are, first, a highly diverse agriculture with different soil and climatic zones, requiring customised farm machinery and equipment and, second, largely small landholdings with limited resources. Credit flow for farm mechanisation is less than 3 per cent of the total credit flow to the agriculture sector. A dedicated Sub-Mission on Agricultural Mechanisation has been initiated in the Twelfth Plan, with focus on spreading farm mechanisation to small and marginal farmers and regions that have low farm power availability.

GCF in Agriculture and Allied Sectors

The GCF in agriculture and allied sectors relative to agri-GDP in this sector has shown an improvement from 13.5 per cent in 2005-05 to 21.2 per cent in 2012-13 at

2004-05 prices. Given the vast investment needs of the sector, greater public investment would only help increase private investment.

MAJOR SCHEMES OF THE GOVERNMENT

Rashtriya Krishi Vikas Yojana (RKVY)

The government has approved continuation of the RKVY scheme during the Twelfth Plan whereby RKVY funding will be routed into three components, viz., production growth, infrastructure and assets, and sub-schemes and flexi-fund. The proposed allocation for implementation of this scheme during 2015-16 is Rs.18000 crore. In view of the need to increase capital formation and get higher returns on investments, states are at liberty to spend up to 100 per cent of total outlay in the infrastructure and asset creation component. The scheme aims at incentivising states to increase investment in agriculture, provide autonomy to States in executing agricultural plans, ensuring better reflection of local requirements, optimising incomes of farmers.

The National Food Security Mission

The National Food Security Mission (NFSM) is being implemented with the new target of additional production of 25 million tonnes of foodgrains comprising 10 million tonnes rice, 8 million tonnes wheat, 4 million tonnes pulses, and 3 million tonnes coarse cereals by the end of the Twelfth Five Year Plan (2016-17). The revamped NFSM is being implemented from 2014-15 in 619 districts of 28 states. In addition to rice, wheat and pulses, crops like coarse cereals and commercial crops (sugarcane, cotton and jute) have been included since 2014-15. Promotion of farmer producer organisation (FPOs), value addition, dal mill, and assistance for custom hiring charges have also been undertaken under the Mission. The pulses component has been allocated fifty per cent of total funds under the NFSM in order to increase their production. To promote the use of bio-fertilisers, subsidy on bio-fertiliser has also been enhanced from Rs.100 per ha to Rs.300 per ha.

Mission for Integrated Development of Horticulture (MIDH)

With effect from 2014-15, the Mission for Integrated Development of Horticulture (MIDH) has been operationalised by bringing all ongoing schemes on horticulture under a single umbrella. Production and distribution of quality planting material, productivity

improvement measures through protected cultivation, use of micro-irrigation, adoption of integrated pest management and integrated nutrient management along with creation of infrastructure for post-harvest management and marketing are focus areas of the MIDH.

Sustainability and Adaptability

Concerns have been raised for quite some time about non-sustainability of the present cropping pattern and use of water resources. The following initiatives announced in Budget 2014-15 have brought the issue of sustainability and climate adaptation to the forefront:

- The Pradhan Mantri Krishi Sinchayee Yojana with allocation of Rs.1000 crore.
- Neeranchal, a new programme with an initial outlay of Rs.2142 crore in 2014 to give additional impetus to watershed development in the country.
- The National Adaptation Fund for Climate Change, with an initial sum of Rs.100 crore and
- A scheme to provide, in mission mode, a soil health card to every farmer, with an allocation of Rs.100 crore. An additional amount of Rs.56 crore has been allocated to set up 100 mobile soil-testing laboratories across the country.

Food Management

The principal policy objective of food management is to ensure food security, particularly for the vulnerable, through timely and efficient procurement and distribution of foodgrains. This involves procurement of foodgrains from farmers at remunerative prices, building up and maintenance of buffer stocks, storage, movement, and distribution of foodgrains to consumers at affordable prices and stability of foodgrain prices. The price instruments used are MSP and central issue price (CIP).

Price Policy for Agricultural Produce

As mandated, the Commission for Agricultural Costs and Prices (CACP) recommends MSPs at national level for twenty-three crops, but effectively price support operates primarily in wheat and rice and that too in selected states. This creates incentive structures highly skewed in favour of wheat and rice. While the country is dependent on imports for pulses and oilseeds (edible oils), their prices often fall below the MSP as there is no effective price support. Since 2012-13, the growth of MSPs of various crops has been moderate.

Procurement

To enhance efficiency of procurement and public distribution and to extend the benefits of MSP to local farmers, the Decentralised Procurement (DCP) scheme has been adopted by some state governments. The central government is urging all state governments to adopt the DCP scheme so that costs of distribution can be saved and outreach of price support mechanism to the farmers in hitherto weaker areas can be improved. To overcome the problem of gaps in the flow of information about procurement operations on day-to-day basis, an Online Procurement Monitoring System (OPMS) has been evolved for reporting and monitoring on a daily basis, procurement operations for wheat, paddy, and coarse grains in the country.

Two decisions that will impact procurement and stocks of rice and wheat from kharif marketing season (KMS) 2014-15 and rabi marketing season (RMS) 2015-16 are: (a) To limit procurement from states that are declaring bonus over and above the MSP to the extent of targeted PDS (TPDS) / other welfare schemes (OWS) requirements (in the case of non-DCP states) declaring bonus, the FCI will not take part in MSP operations in those states) and (b) To cap the percentage of levy on rice at 25 per cent.

This decision has successfully led to dropping of the practice of giving bonus over and above MSP for paddy in states like Chhattisgarh and Madhya Pradesh in KMS 2014-15 and it is expected that the state governments of Madhya Pradesh and Rajasthan will avoid giving bonus for wheat also in RMS 2015-16 in view of this policy. The procurement levels in KMS 2014-15 are lower in both Chhattisgarh and Madhya Pradesh as compared to the previous year and there is re-emergence of competition in the market.

Buffer Stocks

The buffer norms for foodgrains in the central pool which were in existence since April 2005 have been revised in the backdrop of increased off-take of foodgrains under the TPDS in the last few years and with the coming into force of the National Food Security Act.

Agriculture Trade

India has emerged as a significant agri-exporter in a few crops, viz. cotton, rice, meat, oil, meals, pepper, and sugar. As per the World Trade Organisation's Trade Statistics, the shares of India's agricultural exports and imports in world trade in 2013-14

were 2.69 per cent and 1.31 per cent respectively. Agricultural exports as a percentage of agricultural GDP have increased from 9.10 per cent in 2008-09 to 14.05 per cent in 2013-14. During the same period, agricultural imports as a percentage of agricultural GDP also increased from 3.94 per cent to 5.50 per cent.

The import policy for agriculture is often considered as a price support and price stabilisation tool. Increase in tariffs is recommended for agricultural products in response to decline in prices on an ad hoc basis. Reform is required in the import policy of agricultural products. The applied tariffs for imports should be linked in a countercyclical manner with international prices so that the landed prices of imported commodities fall within a known range. This would protect farmers from adverse impact of steep fall in commodity prices, and facilitate long-term investment in agriculture. While the trade policy regime should be stable, it should also be nimble to quickly respond to the changed export duty structure of the exporting countries aimed at pushing value-added products by neutralising our duty differential between raw material and finished product.

Crop Insurance

National Agricultural Insurance Scheme of 2010 is a market based scheme under which actuarial premium rates conforming to product design of the insurance product are determined. Under this system, farmer premiums and subsidies by the government are paid upfront at the beginning of the crop season to the insurer, who would then be responsible for settling all claims. Thus, larger role of the private sector infuses competition and promotes public-private partnership.

Futures Trading in Agri Commodities

An important development during 2015 was that Forwards Markets Commission, the regulator of Commodity futures market, was merged with the Securities and Exchange Board of India (SEBI) in late 2015. Futures trading in agri-commodities accounts for nearly 20 per cent of the total turnover. Food items constitute nearly 60 per cent of futures trading in agri-commodities and non-food items 18 per cent.

CHAPTER – 3

AGRICULTURAL MARKETING

Agricultural Marketing System in a country like India must satisfy the following three objectives: -

1. Ensure a remunerative price for the farmer.
2. Narrow down the difference between the price that a farmer gets and the price at which it is sold to consumers.
3. Minimise the role of middlemen.

In India, agricultural marketing poses various problems for farmers when they wish to sell their produce in markets away from their villages. These problems are as follows:

(i) Lack of warehousing and storage facilities due to which they are forced to sell their produce as soon as it is ready because they cannot store it for want of these facilities and thus cannot hold and wait to fetch better prices.

(ii) Inadequate and inefficient transportation which prevents them from taking their produce to mandis. Not only that there is lack of motorable and mechanized transport but also most of the connecting roads are Kuchha and unpaved roads.

(iii) Lack of grading and standardization facilities due to which they are not able to get better price and it weakens their bargaining power.

(iv) Use of substandard weights and measures due to which their produce may be underweight.

(v) Presence of a large number of middlemen who change several unauthorized commissions due to which the price that the farmer gets is depressed.

(vi) Lack of credit facilities due to which a farmer has to sell his produce immediately after the crop is ready. Adequate credit facilities can enable him to withhold his produce and run his household till he gets a better price.

(vii) Lack of market information by way of prevailing condition in the market as well as prices prevailing.

Over the years, the government has tried to address these problems by adopting the following measures:

(a) Provision of warehousing facilities:

The government set up Central Warehousing Corporation in 1957 with the purpose of constructing and running godowns and warehouses. The States have set up corresponding State Warehousing Corporations. Also, a network of rural godowns has been setup. In recent years, the FCI has taken up construction of its own network of rural godowns.

(b) Grading and standardization has been facilitated by enacting Agricultural Produce (Grading and Standardization) Act. Grading Standards have been laid down for nearly 180 agricultural and allied commodities. The graded goods are stamped with the seal of "AGMARK".

(c) Promoting Cooperative marketing by setting up National Cooperative Development Corporation and NAFED.

(d) Special Boards have been set up for commodities like rice, pulses, jute, millets, cotton, oilseeds, tobacco, sugarcane etc.

(e) Boost to export of agricultural commodities through incentives provided in successive Exim policies and setting up of Export Promotion Council as well as Agricultural and Processed Food Export Development Authority. Also, the Centre has been allocating funds to assist States for the development of Agro Export Zones.

(f) Buffer stocks and procurement policy of the government has helped farmers ~~to market their produce to the government at the price fixed by the~~ government.

(g) Futures Trading has been permitted in various agricultural commodities. Also in 2003-04 the government took a significant initiative towards futures trading in all commodities by setting up national level commodity exchanges like for wheat, cotton, soya oil, jute, rubber, pepper, turmeric etc.

(h) Enactment of model APMC Act 2003 by the Centre with a view to urging States to amend their respective APMC Acts in accordance with this Act. Salient features of this Act are given later in this chapter.

(i) Setting up of Regulated markets has been the most significant and landmark step taken by the government in the field of agricultural marketing.

REGULATED MARKETS

A regulated market is set up under the law either for a specific commodity or a group of commodities. These markets are set up under the APMC Acts of State governments.

This market is administered by a market committee which consists of representatives of the State Government, the legal bodies (like the District Board), the traders and the farmers themselves. The Committee is appointed by the government for a fixed period for management of the market. The Committee fixes the market charges like the commission etc. It ensures that no 'dalal' represents either the buyer or the seller. It prevents unauthorized deductions from the price paid to the farmer and ensures that correct weights and measures are used.

The Committee is responsible for the licensing of brokers and weighmen and is empowered to punish anyone found guilty of dishonest and fraudulent practices. It hears all the complaints and in case of disputes, it arranges for arbitration.

The Chairman and Vice-Chairman of the Committee are from the farming community. The regulated market system has proved a good source of generating income for the marketing boards and this income is used for creating rural infrastructure.

Regulated markets predominate in areas where commercial or non traditional crops are grown. Cooperative marketing and distribution and banking are also linked with the regulated markets. At present, nearly 80 percent of agricultural produce is sold in regulated markets.

Defects of Regulated Markets

These markets have proved a boon for farmers over the years even since they are being set up since 1951. There are nearly 8,500 such markets in the country. However, with changing times, these markets have been exposed to some serious limitations as follows: -

(a) Failure to adopt new innovative market technologies.

(b) They have not helped in exchange of market information.

(c) They have restricted smooth supply of raw materials for agro producers

(d) They have restricted development of alternative forms of markets.

(e) They have become too monopolistic in the sense that the authorities do not permit alternate and competitive markets in an area where there is a regulated market.

(f) Also, no transaction is permitted outside the regulated market. For any such transaction, one has to obtain a licence and pay requisite fee to the market committee.

(g) Cold storage facilities exist in less than 10 percent of these markets which implies poor infrastructure.

(h) Grading, cleaning and standardization facilities exist in just one third of these markets.

In view of these limitations and problems relating to regulated markets, the centre set up Shankar Guru Committee in 2001 and also set up an inter-ministerial expert group to review the system of regulated markets. These Committees, inter-alia, made the following observations and recommendations: -

(i) These markets have become too restrictive and instead of promoting free and fair play of market forces, have become too monopolistic.

(ii) These markets have failed to reflect situations of scarcity or plenty and particularly in respect of food grains have led to stock piling by FCI.

(iii) Government intervention in agricultural markets should be selective and confined only to situations of extreme scarcity.

(iv) Essential Commodities Act should be repealed.

(v) Government should review all the relevant legislations relating to agricultural marketing.

Based on these, the Centre enacted a model APMC Act in 2003 urging State governments to adopt this, legislation by carrying out suitable amendments in their APMC Acts. The model APMC Act 2003 has three major objectives viz., deregulation of

agriculture markets making these markets competitive and permitting private sector investment in market infrastructure.

Salient features of the model Act are as follows:

(i) Farmers and traders should not be obliged to sell their produce in regulated markets.

(ii) Farmers and traders should be permitted to set up purchase centres for direct sale of their produce to consumers.

(iii) States should encourage farmers, traders, local authorities to set up parallel markets.

(iv) Separate markets should be set up for perishable commodities like fruits and vegetables.

(v) Public private partnership should be encouraged in management and development of agricultural markets.

(vi) There should be regulation and promotion of contract farming.

Regulated markets are dominated by intermediaries and middlemen. The high costs of intermediation have a cascading effect on prices. The Committee on Agriculture Reforms set up in 2013 recommended, inter-alia, a barrier-free national market for the benefit of farmers and consumers.

The Committee noted that by and large, the APMCs have emerged as some sort of government sponsored monopolies in supply of marketing services/facilities, with all drawbacks and inefficiency associated with a monopoly.

Thus, the APMC Act has not achieved the basic objective of setting up a network of physical markets. There are some successful initiatives in direct marketing, such as Apni Mandi in Punjab, Uzhavar Sandhai in Tamil Nadu, Shetkari Bazaar in Maharashtra, Hadaspur Vegetable Market in Pune, Rythu Bazar in Andhra Pradesh, Krushak Bazaar in Odisha, and Kisan Mandi in Rajasthan.

Some measures that would facilitate the creation of a barrier-free national market are:

(a) Permit sale and purchase of all perishable commodities such as fruits and vegetables, milk and fish in any market. This could later be extended to all agricultural produce.

(b) Exempt market fee on fruits and vegetables and reduce the high incidence of commission charges on agricultural/horticultural produce.

(c) Taking a cue from the success of direct marketing efforts of states, the APMC/other market infrastructure may be used to organize farmers markets. FPOs/self-help groups (SHGs) can be encouraged to organize farmers markets near urban centres, malls, etc. that have large open spaces. These could be organized every day or on weekends, depending on the concentration of footfalls.

(d) Include 'facilitating organization of farmers markets' under the permitted list of corporate social responsibility (CSR) activities under Companies Act 2013, to encourage companies engaged in agri-allied activities, food processing etc to take up this activity under CSR and also help in setting up supply chain infrastructure. This would be similar to the e-Choupal initiative of ITC Ltd., but under CSR.

(e) All the above facilitators can also tie-up a link to the commodity exchanges' platform to disseminate spot and futures prices of agricultural commodities.

Recent initiatives by the government has been to urge state governments to keep perishable commodities like fruits, vegetables, milk and fish out of the purview of regulated markets.

The Union Budget 2014-15 stated that the Centre would work closely with States to reorient their respective APMC Acts to provide for establishment of private market yards/private markets. Also, that the State Governments would be encouraged to develop farmers markets in town areas to enable them to sell their produce directly. Recent initiatives in agricultural marketing are given below:

(i) The Department of Agriculture (DAC) has issued a comprehensive advisory to states to go beyond the provisions of the Model Act and declare the entire state a single market with one licence valid across the entire state and removing all restrictions on movement of agricultural produce within the state.

(ii) In order to promote development of a common national market for agricultural commodities though e-platforms, the department has approved Rs.200 crore for

a central-sector scheme for Promotion of National Agricultural market through Agri-Tech Infrastructure Fund (ATIF) to be implemented during 2014-15 to 2016-17. Under the Scheme, it is proposed to utilise the ATIF for migrating towards a national market through implementation of a common e-platform for agri-marketing across all states.

(iii) On the request of the central government, a number of state governments have exempted the marketing of fruits and vegetables from the purview of the APMC Act. The NCT of Delhi has taken the initiative in this direction by issuing a notification in September 2014, ending the regulation of fruits and vegetables outside redefined market yard/sub-yard area of the APMC, MNI, Azadpur, APMC, Keshopur, and APMC Shahdara. The Small farmers Agribusiness Consortium (SFAC) has taken the initiative for developing a kisan mandi in Delhi with a view to providing a platform to FPOs for direct sale of their produce to prospective buyers totally obviating or reducing unnecessary layers of intermediation in the process. They plan to scale their activities in other states based on the outcome of the experience of the Delhi Kisan Mandi.

E-Chaupal:

E-Chaupal is the first private sector initiative in Agricultural Marketing. It is a business platform consisting of a set of organisational sub-system and interfaces connecting farmers to global markets. This common structure can be leveraged to procure/produce a host of products and services for the farmer as a producer as well as a consumer. The e-chaupal business platform consists of three layers, each at different levels of geographic aggregation. Each of the three layers is characterized by three key elements:

(a) the infrastructure (physical or organizational) through which transactions take place,

(b) the entity (person or organisation) orchestrating the transaction, and

(c) the geographical coverage of the layer.

The first layer consists of the village level Kiosks with internet access (or e-chaupal) managed by an ITC-trained local farmer (called a sanchalak) and within walking distance (1-5 kms) of each target farmer. There may be generally one e-chaupal per cluster of five villages.

The second layer consists of a bricks-and-mortar infrastructure (called hubs) managed by the traditional intermediary who has local knowledge/skills (called a sanyojak in his new role) and within tractorable distance (25-30 Kms.) of the target farmer. The ITC chose to operate the platform on the following three business principles:

(i) Free information and knowledge which ensures wider participation by the farmers.

(ii) Freedom of choice in transactions (farmers after accessing information at the e-chaupal, are free to transact their own way).

(iii) Transaction based income, stream for the sanchalak by tying his revenue stream to the transaction (on a commission basis).

The ITC has provided internet access in rural areas in several regions of the country which enables farmers to directly negotiate the sale of their produce with ITC. The farmers do not have to pay for the information and knowledge they get from the forum of e-chaupals. The principle of e-chaupal is to inform, empower and compete on the basis of click and mortar capability. There are close to 7,000 e-chaupals in operation.

Pink Revolution

India has already seen the 'green' and 'white' revolutions in its food industry come to pass; it now seems well on its way to realizing a 'pink revolution' too; the modernization of meat production processes. India needs a 'pink revolution' with an objective of affordable health to all.

The Food and Agricultural Organisation of the UN (FAO) has found that India is well on its way to modernizing meat and poultry processing, thus realizing the 'pink revolution' too. In a report titled the 'Indian Meat Industry Perspective', the FAO outlined four steps that should be taken if India's food industry is to successfully go pink.

These recommended steps were: setting up state of the art meat processing plants; developing technologies to raise male buffalo calves for meat production; increasing the number of farmers rearing buffalo under contractual farming; and establishing disease-free zones for rearing animals.

India has already become quite rosy and meat production has been steadily growing over the past decade. According to the United States Department of Agriculture (USDA) Foreign Agricultural Service, India became the largest exporter of buffalo meat

in 2012, exporting approximately 1.5 million metric tons of beef. The largest importers of Indian meat are primarily countries in the Middle East and South East Asia.

The USDA also found that a record 3.2 million tons of broiler meat (i.e. chicken) had been produced in India last year. The broiler sector has seen a 30 percent growth since 2009 and is among the fastest growing sectors in the Indian economy at a rate of 8 percent. This increase has been largely attributed to growing domestic demands.

Although the pink revolution has stimulated economic and production gains in India, it is important to also examine what some of the environmental and health risks associated with going 'pink' are. It is important to shed light on some of the often overseen, or plausibly ignored, problems associated with 'state-of-the-art' meat production.

In the wake of climate change, growing livestock production is a global concern. The FAO has estimated that approximately 18 percent of global greenhouse gas emissions come from livestock production. Despite its significant effect on climate change, meat production and consumption, and the food system more generally, is not always included in environmental discussions in India and elsewhere.

To produce one calorie from animal protein, 11 times as much fossil fuel is required than to produce one calorie from plant protein. Energy is devoured by growing feed, transporting feed, transporting animals, processing animals, packaging meat, transporting meat and keeping meat cold.

The amount of water that is required to irrigate crops, or provide drinking water for animals is also vast. On a global scale, agriculture represents 70 percent of blue water use, water which is taken from surface or groundwater sources. In India, 873 litres is used to produce one kilo of chicken meat, and 1,471 litres of blue water is used to produce beef in industrial systems. One might argue that you save more water by not eating a kilo of meat, than you would by not showering for six months.

Of concern is not only what goes into producing meat, but also what comes out. The horrors of industrial food animal production facilities are known. Characteristically they confine and concentrate large animal populations in small areas who experience short-lived, poor quality lives. However, beyond the ethical considerations of animal welfare, meat production facilities can also pose significant risks to human health and the environment.

The amount of excrement animals produce is far more than humans, yet their waste is even more unlikely to be treated properly. Much of the animal waste produced in the process of turning living animals into meat is used as fertilizer and applied to land, or runs off into streams and other surface water bodies.

Animal waste may be a useful as a fertilizer; however it may also be a serious source of contamination and pollution of groundwater and air. The concentration of parasites, bacteria's and chemical contaminants in animal waste can have drastically detrimental effects on ecosystems, and communities living near waste disposals.

Modernized mass production of meat makes its case for not only producing more meat, more efficiently but also producing meat which can be better controlled, and standardized for consumers. If India is going to become a heavy weight meat producer, is the pink revolution the better direction? Will the big players be easier to control?

The Ministry of Food Processing Industries (MOFPI) has found that a handful of large companies are already changing the Indian meat production landscape by introducing modern state-of-the-art slaughter and processing plants, as well as implementing the vertical integration management in poultry production.

The government-backed Food Safety and Standards Authority of India (FSSAI), set up under the Food Safety Act and Food Safety Bill (both from 2006), aims to raise local standards of meat production. However their vision for meat production in India is largely to continue on the path of 'modernizing' by adopting industrial-style production facilities.

The Agricultural and Processed Food Products Export Development Authority of the Indian Government (APEDA), has approved 70 integrated abattoirs, slaughter-houses, and meat processing plants across the country. Some laws and regulations have been designed to guarantee the quality of exported meat from India in line with requirements set by importing countries. Whether the same standards are set and as strictly enforced for domestically consumed meat is more difficult to determine.

Some have argued that increasing the production of meat is an important step to improving food security in India. The validity of this argument is questionable at best given how resource intensive the production of meat products is. According to the United Nations, 30 percent of the earth's landmass is devoted to raising animals to become

meat. This includes land that is used for grazing and for crop growth which is used as feed.

Livestock consume much of the same food products we consume such as grains, soybeans, oats and corn, yet to the meat, eggs and dairy products animals yield when consuming these foods is comparatively small. It takes 5 kgs of grain to produce less than half a kilo of meat. Any diversion of farmland to rear livestock could have terrible consequences for India, considering it is home to the largest number of famished people worldwide. It was estimated just last year that approximately one-fifth of the total Indian population was eating less then was needed to be healthy.

The problems India faces in regard to food security is not only the amount of food being produced, but also the lack of access to food and different varieties of food and a lack of household income people have to afford food. Other factors which destabilize food security include instability of international trade, man-made disasters (including environmental degradation), as well as conflict, terrorism and corruption.

CHAPTER – 4

FOOD PROCESSING INDUSTRIES

Food Processing Industry in India is of a relatively recent origin as consumption of processed food itself has seen a manifold rise due to fast changing life styles, increasing number of working women, shift in India's demographic profile with 65 per cent of India's population below 35 years of age, increase in disposable incomes and the growth of organised food retail. Also, India has a huge and fast expanding consumer market with large and diversified production base. Nearly 55 per cent of consumption expenditure of India's rural population is on food and grocery while that of urban population is 40 per cent.

India is strategically located at the centre of Middle-East and South-east Asia with a long coastline and proper sea route connectivity as well as sufficient availability of raw materials for long periods. As a result India provides an attractive destination for multinational food companies to set up processing facilities in India both to cater to exports as well as domestic market. India is one of the world's largest food producer, largest producer of fresh fruits and second largest producer of vegetables after Brazil. Also it ranks fifth in poultry production and is the largest producer of milk. As such, both investors and exporters have ample opportunities for investment in food and food processing technologies skills and equipment specially in areas of canning, dairy and food processing, speciality processing, packaging and frozen food/refrigeration. Fruits and vegetables, fisheries, milk and milk products, meat and poultry, packaged/ convenience foods, alcoholic beverages and soft drinks and grains are important sub sectors of the food processing industry. Health food and supplements are another rapidly rising segments of this industry. Soft drink bottling, confectionary manufacture, fisheries, aquaculture, grain-milking and grain based products, meat and poultry processing, milk processing tomato paste, fast food, ready to eat breakfast cereals, food additives, flavours etc. have emerged as the most promising sub sectors.

The Ministry of Food Processing Industries is concerned with formulation and implementation of the policies and plans for the food processing industries within the overall national priorities and objectives. The Ministry acts as a catalyst for brining in greater investment into this sector, guiding and helping the industry, and creating a

conducive environment for healthy growth of the food processing industry. Within these overall objectives, the Ministry aims at better utilization and value addition of agricultural produce, minimizing wastage at all stages in the food processing chain by development of infrastructure for storage, transportation and processing of agro-food produce, induction of modern technology into the food processing industries, encouraging R&D in food processing for product and process development, providing policy support, promotional initiatives and facilities to promote value added exports, creating the critical infrastructure to fill the gaps in the supply chain from farm to consumer.

Food processing industries include all those items pertaining to the following two processes viz.:-

(a) Manufactured process. If any raw product of agriculture, animal husbandry or fisheries is transformed through a process (involving employees, power, machines or money) in such a way that its original physical properties undergo a change and if the transformed product is edible and has commercial value, then it comes within the domain of food processing Industries.

(b) Other value-added process: If there is significant value addition (increased shelf life, shelled and ready for consumption) such produce also comes under food processing, even if it does not undergo manufacturing processes.

Food Processing Industry ranks as the 5th largest industry in India in terms of production, consumption and exports. It employs over 16 percent of total workforce in organised manufacturing sector and 32 percent in unorganised manufacturing sector. It currently employs 13 million people directly and 35 million people indirectly. It has the potential to generate significant employment as the multiplier effect of investment is 2.5 times than in other industries. This industry is dominated by unorganized sector which contributes more than 70 percent of output in value and 50 percent in volume.

While the food-processing sector offers several opportunities, it faces several constraints which impede its growth. These are as follows:

(a) Low Level of Government Outlay for Development of Food Processing Industries - During 11th Plan an outlay of Rs. 4031.00 crores was envisaged but in last 4 years only Rs. 1132.00 crores have been spent. The Vision 2015 envisages public expenditure of Rs. 10,000 crores by 2015.

(b) APMC Acts of State Governments discourage direct marketing arrangement between farmer and processor. The processor is required to obtain license from the respective state government as well as liable to pay market fees without even using mandi infrastructure.

(c) Essential Commodities Act, Stock Order etc. The Essential Commodities Act (ECA) 1955 was put in place after independence to control production, supply and distribution of essential agricultural commodities and was put in place to ensure availability of food products. In the current context of liberalization, controlling the movement of products by licensing of dealers, limits on stocks and control on movements only hamper the growth of the agricultural sector and promotion of food processing industries.

(d) Food Quality Regulation Government has enacted an Integrated Food law, but the mechanism envisaged is yet to become operational.

(e) Taxes on processed food items Incidence of taxation in processed agricultural products not only acts as a disincentive for investment in the sector but also affects the competitiveness of the food products in the country. Though primary agricultural commodities including fruits and vegetables are mostly exempted from tax, processed food commodities are subject to a variety of taxes. In most of the states, low value added food products are exempted from VAT. However, certain high value added food products like biscuits, confectionary, snack items are levied VAT at the rate of 12.5% in many states.

Apart from VAT, other taxes such as purchase tax, entry tax, octroi etc are also levied on food products. Also, packaging material (OTS cans, aseptic packaging paper and aseptic bags) which constitutes around 35-50% of the production cost of packaged food attracts excise duty. In case of snack food items, import tariffs are as high as 30-65% which escalates its market price manifold. Also, it is mandatory for imported processed products to have at least two-thirds of their shelf life remaining on reaching the port.

(f) Non-tariff barriers like food labelling requirements for packaged goods and compulsory detention and laboratory testing of samples of each imported item, which boosts overhead costs.

(g) Lack of infrastructure for post harvest handling and storage, absence of cold chain facilities and fragmented supply chain of food products are some of the critical reasons holding back the growth of food processing industry in the country.

(h) No institutional mechanism to mitigate the small and fragmented size of farm holdings and to facilitate linkage between the farmer and the processors/market. The Mega Food Park Scheme and the Cold Chain Scheme of the Govt. of India envisage addressing these to a great extent.

(i) Reliable database for food processing industry does not exist currently in the country, which affects the planning process. Considering the high risk involved in food processing, a supportive insurance policy is critical to the growth of the sector, which does not exist currently.

(j) R&D in the food processing sector in the country is largely governed by universities and institutions with very little involvement of industry. The research is also on traditional lines with less emphasis to market preferences. There is a need to involve industry for product development setting up of food development centres/incubation centres on a regional basis in various prominent agro-climatic zones.

(k) The current Indian crop production system largely continues to be traditional and subsistence agriculture. As a result, crop varieties being grown are not in tune with market and processing requirements.

(l) There are problems like adherence to food quality standards by most of the players in the industry, lack of skilled manpower, absence of market driven farming, high cost of transportation and lack of credit facilities.

Tue recognition to this sector was given only from the Eleventh Five Year Plan (2007-2012) by not only a substantial raise in the outlay allocated to this industry but also by initiating the most ambitious scheme of setting up Mega Food Parks in the year 2009-2010. Various other initiatives taken during this plan were as follows:

1. Establishment of cold chain, value addition and preservation infrastructure
2. Modernization of Abattoirs
3. Technology upgradation

4. Human resource development
5. Entrepreneurship development programme
6. Setting up Food processing training centres
7. R and D and setting up of/upgradation of food testing laboratories
8. Upgradation of equality of street food
9. Strengthening of institutions relating to this industry.

MEGA FOOD PARKS

The primary objective of the MFPS is to provide adequate / excellent infrastructure facilities for food processing along the value chain from the farm to market. It will include creation of infrastructure near the farm, transportation, logistics and centralized processing centres. The main feature of the scheme is a cluster based approach. The scheme will be demand driven; pre-marketed and would facilitate food processing units to meet environmental, safety and social standards.

The expected outcome is increased realization for farmers, creation of high quality rural processing infrastructure, reduction in wastage, capacity building of the producers and processors and creation of an efficient supply chain along with significant direct and indirect employment generation.

The scheme aims to facilitate the establishment of a strong food processing industry backed by an efficient supply chain, which would include collection centres, primary processing centres and cold chain infrastructure. The food processing units, under the scheme, would be located at a Central Processing Centre (CPC) with need based common infrastructure required for processing, packaging, environmental protection systems, quality control labs, trade facilitation centres, etc.

CPC would be supported by farm proximate Primary Processing Centres (PPC) and Collection Centres (CCs) in identified locations based on a techno-feasibility study, adequate to meet the requirement of the CPC.

Core Processing Facilities would include cleaning, grading, sorting and packing facilities, reefer vans, mobile pre-coolers, mobile collection vans etc. The Central Processing Centres will have buildings for common facilities like Testing Laboratory (including equipments), Cleaning, Grading, Sorting and Packing Facilities (including equipments), Dry Warehouses, specialized storage facilities including Controlled

Atmosphere Chambers, Pressure Ventilators, variable Humidity Stores, Pre-cooling Chambers, Ripening Chambers etc. (including equipments), Cold Chain Infrastructure including Reefer Vans, Packaging Unit, Irradiation Facilities, Steam Sterilization Units, Steam Generating Units, Food Incubation-cum-Development Centres etc.

Enabling Infrastructure would include roads, drainage, water supply, electricity supply including captive power plant, effluent treatment, telecommunication lines, parking bay including traffic management system, weighbridges etc. at the PPC and CPC level.

Special Purpose Vehicle (SPV)

The responsibility of execution, ownership and management of the Mega Food Park would vest with a Special Purpose Vehicle [SPV] in which Financial Institutions/ Banks, Organized Retailers, Processors, Service Providers, Producers, Farmer Organizations and other related stakeholders would be the equity holders. The preference for sanctioning assistance under the Scheme would be given to those SPVs in which industry units with the plans of processing wide range of perishable products will have major stake.

Government agencies can also become shareholders in SPV, if they so desire, holding should be less than 26% of share capital so as to ensure private sector character of the SPV.

The Food Safety and Standards Act, 2006

The Act came into effect from August, 2011 with the notification of enabling Rules and Regulations. This has thus consolidated all existing food laws in the country with the repealing of existing Central Acts. The Act has laid down science based standards for manufacturing, storage distribution and sale of all food products. Under the Act, there are also commissioners of Food Safety at State Level.

Codex Standards: These are standards developed by FAO and WHO to protect the health of consumers and ensure fair practices in food trade. These are reference parts for international trade in food products.

Twelfth Five Year Plan

An outlay of over 15,000 crores has been earmarked for this sector during the plan. The most significant initiative being proposed during 12th Plan is launching of a

National Mission on Food Processing (NMFP). This would be decidedly a paradigm shift in the Ministry's approach and is driven by the need to make food processing truly a national initiative. It is also fully realized that unless State Governments become implementing agencies of Ministry's various Schemes and programmes, there would remain a limitation on size and depth of Ministry's programmes. The success achieved by initiatives like National Horticulture Mission also suggests that Ministry may adopt a similar approach to reach farmers and small entrepreneurs. The NMFP is thus guided by twin principles of Decentralization and Outreach.

The Mission seeks to make India a global leader in production, consumption and export of safe, hygienic, nutritious and quality processed food items by enhancing processing levels, value addition and reduction in wastage, institutional strengthening, food safety and quality assurance and capacity building. The targets of the Mission are:

1. increasing the levels of processing of perishables from 6 percent to 20 percent
2. value addition from 20 to 30 percent
3. increasing share of India in global food trade from 1.5 to 3 percent
4. skill development to the tune of 1.5 million

Objectives of NMFP

(a) To spread the message of significance of good processing for enhancing agricultural productivity and farmers income in the country.

(b) To assist the State Governments in creating requisite synergy between their agricultural plans and development and food processing sector.

(c) To assist the State Governments in addressing both institutional and infrastructural gaps along the value chains and thus create efficient supply chains for agricultural produces.

(d) To promote initiative for skill development, training and entrepreneurship which would meet needs of both post-harvest management and food processing industry.

(e) To assist MSMEs in setting up/modernization of food processing units by providing need based support in terms of capital/technology/skill etc.

(f) To assist food processing industry to need requisite standards in terms of food safety laws and market demand, both domestic and international.

Five Guiding Principles of the Mission:

(a) Organising the unorganized food processors, including Self-Help Groups, to help them reap advantages of Mission initiatives.

(b) Ensuring advantages of programmes/Schemes/institutions/infrastructure of NFMP reach Micro and Small Enterprises on preferential basis.

(c) Dedicated, professional, sensitive and accountable support structure to initiate and implement the Mission initiatives in a transparent manner.

(d) Mission initiatives to be shaped and driven by proposed beneficiaries.

(e) Adoption of best practices for scaling up programmes/initiatives.

A list of major schemes and programmes covered in the mission is given below:

- Technology upgradation
- Supporting cold chain facilities for non-horticulture produces and Reefer vehicles
- Creation of primary processing centres/collection centre in rural areas.
- Modernisation of abattoirs
- Modernisation of meat shops
- Human Resources Development
- Promotional activities like seminars/workshops/studies/surveys/exhibition/ fairs advertising/publicity
- Upgradation of quality of street food

All these schemes would be implemented as centrally sponsored schemes or through additional of central assistance route by giving responsibility of implementation to the state governments. The mission would operate at National, State and District levels.

The government has announced fiscal incentives over the years to food processing industries. These incentives are in the form of sops in income tax, excise

duty and custom duty besides listing many of the processes in the negative list for purpose of service tax. Many of the tax incentives have also been provided for food processing machineries as well as packaging equipment. The Union Budget 2014-15 also proposed setting up of a special fund of Rs. 2000 crores to provide credit at affordable rates to the food processing sector. Besides, an amount of Rs. 100 crores has been provided for Agri-Tech Infrastructure fund.

Besides, in recent years, excise duties have been brought down on machinery for preparation of various processed food items.

The latest initiative to give a boost to this sector has been the inauguration of a National Food Park by the Prime Minister in October, 2014 at Tumkur in Karnataka at the Vasantha Narasapura industrial belt 90 kms. from Bangalore. The park will provide infrastructure facilities to the sector along the value chain from the farm to the market.

The food park is a public private partnership programme of the Union Ministry of Food Processing Industries. The food park is an initiative of Future Group chief Kishore Biyani.

The 110 acre park will have world class food processing and cold storage unit. The Future Group has invested Rs. 140 crore and another Rs. 120 crore is required before it is fully commissioned.

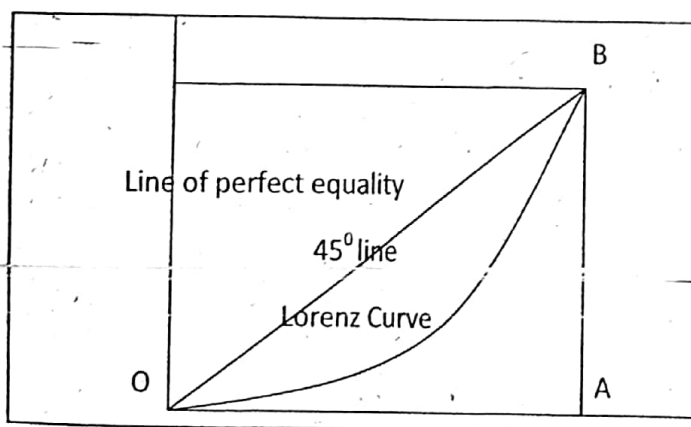
The state government has allotted the land under the Karnataka Industrial Areas Development Board (KIADB). It would be equipped with 60 medium-sized food processing units that would make ready-to-eat products. In addition, there would also be in-house pulping, milling, flouring, spice and dal units.

CHAPTER – 5

POVERTY AND UNEMPLOYMENT

Poverty is a state of pronounced deprivation in terms of command over commodities in general. A greater command over resources implies lower level of poverty and vice versa. As such, poverty is measured on the basis of income or consumption by adopting a threshold in monetary terms which in India is per capita household expenditure.

The definition of Poverty Line has caused extensive debate in the country as estimates of per capita household expenditure have been unrealistic. The latest estimate in this regard is the Rangarajan Committee Report in 2014 according to which, the poverty line should be Rs.32 per day in rural areas and Rs.47 in urban areas, as against the earlier estimate of Rs.27 and Rs.33 respectively. The Rangarajan Committee's methodology to calculate poverty line is based on parameters like clothing, house rent, conveyance, education, adequate nourishment, average calorie requirements, protein and fats etc. A household has been considered poor if it is not able to save.

Poverty is both absolute and relative. The former is defined on the basis of poverty line while the latter is defined on the basis of inequalities i.e. households whose income is less than the average income of a society. Inequalities in society are measured by Lorenz Curve shown below:

A straight line at an angle of 45° from the start on the graph indicates perfect equality. The curve below this line shows inequality. The greater the inequality, the greater will be the degree of curvature.

A coefficient based on the Lorenz Curve is called Gini Coefficient which measures inequalities as follows:

$$G = \frac{\text{Area OCB}}{\text{Area OAB}}$$

If the frequency distribution is equal, the Lorenz Curve coincides with the 45° line and G = 0.

The official method to estimate poverty above is the Head Count Ratio (HCR) which is calculated by dividing the number of people below the Poverty Line by the total population. This is the proportion of poor in the total population. Head Count Ratio makes no distinction between people just below the Poverty Line and those much below the Poverty Line. This distinction is appropriately brought out by an index called Poverty Gap Ratio which is calculated as the average difference between Poverty Line and actual income or consumption for all poor households, expressed percentage of the Poverty Line. In other words, it is defined as the mean distance the Poverty Line expressed as a proportion of that line (where the mean is formed over the entire population, counting the non-poor as having zero poverty gaps). The poverty gap thus measures the transfer that would bring the income of every poor person exactly up to the Poverty Line.

The Planning Commission is the nodal agency for estimating the number and proportion of people living below the Poverty Line at National and State levels, separately for rural and urban areas. Poverty estimates are based on a large sample survey of household consumption expenditure carried out by the National Sample Survey Organisation (NSSO) after an interval of approximately five years.

The Planning Commission has updated the poverty lines and poverty rates for 2011-12 based on the recommendations of Tendulkar Committee. Accordingly, with the Poverty Line at all India level at monthly per capita expenditure of Rs. 816 for rural areas and Rs. 1000 for urban areas in 2011-12, the poverty ratio declined from 37.2 percent in 2004-05 to 21.9 percent in 2011-12.

According to Human Development Report, severe poverty remains a major problem throughout much of the developing world. An estimated 1.57 billion people or more than 30 percent of the population of the 104 countries live in multidimensional poverty, including 612 million people in India. On the newly constituted Multi dimensional

poverty Index (MPI) which identifies multiple deprivations in the same households in education, health and standards of living, only 29 of the 186 countries do worse than India. The MPI puts India's poverty head count ratio at 54 percent which is higher than Bangladesh and Nepal.

The Human Development Report estimates the Human Development Index (HDI) in terms of three basic parameters: to live a long and healthy life, to be educated and knowledgeable, and to enjoy a decent economic standard of living. India's rank in HDI is 135 out of 187 countries in 2014. There is also the inequality adjusted HDI prepared by HDR for nearly 140 countries which takes into account loss of human development due to inequality in health, education and income.

India's rank is lowest amongst BRICS countries and also below the average of countries in both the medium human development groups (0.164 against India's 0.586) and in South Asia (0.588).

In terms of gender equality, the HDR ranks India at 127 out of 152 countries. Thus, India is in the bottom 25 percent of all countries in the HDI, it ranks in the bottom 20 per cent of the gender inequality index.

Poverty and deprivation are acute in India even in terms of Misery Index which is prepared by combining high rate of unemployment and high rate of inflation in a country.

Causes of Poverty:

The extent of poverty in an economy is due to a wide range of factors as follows:

(i) Underdeveloped nature of economy.

(ii) Rapid growth of population in an overpopulated country; even if the national income increases, the per capita income remains the same due to increase in population.

(iii) Large inequalities in the ownership of earning assets such as land, buildings, etc.

(iv) Low level of productivity in agriculture and industry,

(v) Large scale unemployment and under-employment.

(vi) Inequality of opportunity in acquiring education and skills.

(vii) State Policy

(viii) Regional disparities

The main determinants of poverty in a country like India are generally reflected in terms of:

(i) lack of income due to a lack of productive employment and under employment;

(ii) increasing prices of food grains which constitute the major item in the consumption basket; and

(iii) inadequate social infrastructure affecting the quality of life of the people and their ability to take up gainful employment.

Among various factors contributing to poverty alleviation, economic growth in terms of its trickle-down effect has always been regarded as an important factor. However, it is not economic growth per se but also the sectoral composition of growth. If growth is concentrated more in agriculture and rural sectors, it may lead to much larger alleviation of poverty in India than if it is concentrated say, in large scale industries. Similarly, factors like physical and social infrastructure, focus on increasing productivity of small farmers, generation of employment opportunities, control of population expenditure on human development etc. help alleviate poverty to a large extent.

The Multidimensional approach to measure poverty, developed by the UNDP since 2010, has replaced the earlier index viz. Human Poverty Index and is based on assessing health, education and standard of living on the basis of parameters like nutrition and infant mortality (for health), years of schooling and children enrolled (for education) and toilets, water, cooking food, electricity, floor and assets (for standard of living).

Government initiatives to eradicate poverty are based on cafeteria approach index which social safety net, progressive taxation, food security, special anti poverty programmes, high social sector spending, socio-economic planning, decentralisation, inclusive growth, etc.

UNEMPLOYMENT

There have been structural changes in India's employment scenario in the decade between 2004-05 to 2011-12 in the sense that for the first time, the share of primary sector in total employment has dipped below the halfway mark from 58.5 per cent in

2004-05 to 48.9 per cent in 2011-12. Employment in the secondary and tertiary sectors increased to 24.3 per cent and 26.8 per cent respectively in 2011-12 from 18.1 per cent and 23.4 per cent respectively in 2004-05. Self employment continues to dominate with a 52.2 per cent share in total employment. What is significant is the significant share of workers engaged in low-income generating activities.

The extent of unemployment in India is generally measured on the basis of three different concepts used by the National Sample Survey Organisation, as follows:

(i) Usual Status or chronic unemployment (in terms of number of persons) which means number of persons who remain unemployed for a major part of the reference period - in this case, a year.

(ii) Current Weekly Status Unemployment (in terms of number of persons) which is measured in terms of the number of persons who did not find even an hour of work during the reference period - in this case, a week.

(iii) Current Daily Status (CDS) Unemployment (measured in terms of number of days or person years) which means the number of persons who did not find work on a day or some days during the Survey week. This is considered to be the most comprehensive measure of unemployment. The 11th Plan has largely used this measure for estimation of employment and unemployment in India. CDS estimate of unemployment is the highest in India as this is the broadest measure.

Unemployment and underemployment in India can be attributed to the following reasons:

(i) Low productivity in the agricultural sector;

(ii) Low employment creation capacity of the industrial and tertiary sector. For example, while tertiary sector accounts for more than 50 percent of the national income, it absorbs just about 20 percent of the labour force;

(iii) Defective education system implying lack of focus on vocationalisation;

(iv) Lack of manpower planning;

(v) Failure to prevent migration of labour force from rural to urban areas;

(vi) Failure to promote labour-intensive production;

(vii) Inadequate growth of infrastructure including, particularly, rural infrastructure which could engage the growing labour force;

Generation of additional employment opportunities has been an integral part of planning strategy. It is felt that an employment-oriented strategy of economic development provides the best answer to the challenges of unemployment and under-employment. Such a strategy involves sector-specific approach focussing on sectors, regions and activities which have high employment elasticity. Agriculture and allied sectors, rural industrialisation, small-scale industries, rural infrastructure and sunrise industries are particularly identified as high employment generating sectors/activities. Not only increasing employment opportunities are to be provided, but the backlog of the unemployed also has to be met. A survey done by the NSSO reveals that two third of the total unemployment exists in the rural sector and one third in urban sector.

The increasing diversification of the economy together with acceleration in economic growth has resulted in structural changes in the nature of the job market. The average annual growth rate of overall employment in both the organised and un-organised sectors has decelerated primarily due to slower growth in agricultural employment, with the absolute number of persons employed in agriculture showing a decline.

Employment in sectors like trade, transport, construction, financial services, storage and communications has grown faster than the average and the share of these sectors in total employment has increased. This reflects the structural changes in product markets in the post-reform period. For growth to be inclusive it must create adequate livelihood opportunities and add to decent employment commensurate with the expectations of a growing labour force.

Skill development has been an important plank of employment generation policy in the Eleventh Plan. The National Skill Development Council has undertaken several initiatives in this regard which include training projects, skill development for early school leavers and existing workers, vocational training etc.

Sluggish employment growth

A cause for concern is the deceleration in the compound annual growth rate (CAGR) of employment during 2004-05 to 2011-12 to 0.5 per cent from 2.8 per cent during 1999-2000 to 2004-05 as against CAGRs of 2.9 per cent and 0.4 per cent

respectively in the labour force for the same periods. After a period of slow progress during 2004-05 to 2009-10, employment generation picked up during 2009-10 to 2011-12 but not keeping pace with the increase in labour force. Based on current daily status (CDS), CAGR in employment was 1.2 per cent and 2.6 per cent against 2.8 per cent and 0.8 per cent in the labour force respectively for the same period.

There are other issues of concern like poor employment growth in rural areas, particularly among females. Though employment of rural males is slightly better than that of females, long-term trends indicate a low and stagnant growth. Such trends call for diversification of livelihood in rural areas from agriculture to non-agriculture activities. In order to improve generation of productive employment under the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA), the Intensive and Participatory Planning Exercise (IPPE) has been initiated to prepare the labour budget for financial year 2015-16 in selected 2500 backward blocks using participatory rural appraisal technique. Emphasis has been laid on agriculture and allied activities to ensure that at least 60 per cent of the works in a district in terms of cost is for creation of productive assets linked to agriculture and allied activities through development of land, water, and trees.

A major impediment to the pace of quality employment generation in India is the small share of manufacturing in total employment. However data from the sixty-eighth NSSO round (2011-12) indicates a revival in employment growth in manufacturing from 11 per cent in 2009-10 to 12.6 per cent in 2011-12. This is significant given that the National Manufacturing Policy 2011 has set a target of creating 100 million jobs by 2022. Promoting growth of micro, small, and medium enterprises (MSME) is critical from the perspective of job creation which has been recognized as a prime mover of the development agenda in India. Although total informal employment increased between 2004-05 and 2011-12, it is significant that informal unorganized sector employment declined leading to an increase in informal organized sector employment. Consequently the share of unorganized labour has declined from 87 per cent to 82.7 per cent.

NSSO rounds are quinquennial and therefore information on the employment/ unemployment situation in the country is available only after a gap of five years. To make available data in the interregnum, the Labour Bureau conducts household employment-unemployment surveys on annual basis and has also been bringing out quarterly survey reports on the effects of the economic slowdown on employment in

select sectors in India since 2009. The results of the latest quarterly summary on employment, July 2014, indicate an increase in employment by 3.5 million since the first survey.

The US (Unorganised Sector) unemployment rate is generally regarded as the measure of chronic open unemployment during the reference year; while the CDS (Current Daily Status) is considered a comprehensive measure of unemployment, including both chronic and invisible unemployment.

Thus, while chronic open unemployment rate in India hovers around a low of 2 per cent, it is significant in absolute terms. The number of unemployed people (under US) declined from 11.3 million during 2004-05 to 9.8 million in 2009-10 but again increased to 10.8 million in 2011-12.

However, based on the CDS the number of unemployed person days declined from 34.3 million in 2004-05 to 28.0 million in 2009-10 and further to 24.7 million in 2011-12. Thus there has been a significant reduction in chronic and invisible unemployment from 8.2 per cent in 2004-05 to 5.6 per cent in 2011-12. Despite only a marginal growth in employment between 2009-10 and 2011-12, the reason for the decline in unemployment levels could be that an increasing proportion of the young population opts for education rather than participating in the labour market. This is reflected in the rise in enrolment growth in higher education from 4.9 million in 1990-91 to 29.6 million in 2012-13.

Labour Reforms

Significant improvement in industrial harmony in India is evident from the fact that man days lost on account of strikes and lockout have been steadily declining: from 17.6 million in 2009 to 14.46 million in 2011, and further to 3.65 million during 2013 and 1.79 million from January 2014 to 9 December 2014.

The multiplicity of labour laws and difficulty in complying with them has always been cited as an impediment to industrial development in India. In a major initiative for ensuring compliance and promoting ease of doing business, the government has initiated a number of labour reform measures.

Thus amendments have been proposed to labour laws to align them with the demands of a changing labour market. Individually, states like Rajasthan have also

introduced major reforms in three labour legislations: the Industrial Disputes Act, Factories Act, and Contract Labour Act.

Salient features of various employment generation of poverty alleviation programme are given below:

Mahatma Gandhi NREGA

This flagship programme of the government aims at enhancing livelihood security of households in rural areas by providing at least one hundred days of guaranteed wage employment in a financial year to every household whose adult members volunteer to do unskilled manual work with the stipulation of one-third participation of women. The MGNREGA provides wage employment while also focusing on strengthening natural resource management through works that address causes of chronic poverty like drought, deforestation, and soil erosion and thus encourage sustainable development. The MGNREGA is implemented in all districts with rural areas.

Mahatma Gandhi NREGA aims at providing not less than 100 days of guaranteed wage employment in a financial year to every rural household, with a stipulation of one-third participation of women, through creation of assets that address causes of chronic poverty like drought, deforestation, and soil erosion, thus encouraging sustainable development. With wages indexed to the consumer price index for agricultural labour (CPI-AL), the average wage under the scheme has increased substantially over the years, resulting in improvement in the bargaining power of agriculture labour. It has also led to improved economic outcomes, especially in watershed activities, and reduction in distress migration.

Some recent initiatives under the programme are as follows: -

- Inter-departmental convergence and collaboration activities like construction of individual household latrines under the Nirmal Bharat Abhiyan (NBA), construction of anganwadi centres under the Integrated Child Development Services (ICDS) Scheme, construction of village playfields under the Panchayat Yuva Krida aur Khel Abhiyan, and convergence with watershed management programmes.
- Steps to open individual bank/post office accounts for all women workers.
- Identifying and providing job cards to widowed, deserted, and destitute women.

- Initiatives for the disabled and other vulnerable persons by fixing schedule of rates (SoR) based on work and time motion study at state level.
- Adding new works to the existing list of permissible works specifically focused on rural livelihood and agricultural activities.

A review of the programme is constantly reviewed to ensure that more such activities and areas are taken up which lead to creation of assets rather than mere generation of income for beneficiaries. Also, steps are taken from time to time to plug corruption and leakages of funds.

National Rural Livelihoods Mission (NRLM)

NRLM aims at organizing all rural poor households and continuously nurturing and supporting them till they emerge out of abject poverty, by organizing one woman member from each household into affinity- based women self-help groups (SHGs) and their federations at village and higher levels by 2024-25. The objective is to ensure that each family, once it is in the SHG network for a period of 6-8 years is able to achieve household food security and have 3-4 stabilized livelihoods through a strong convergence with panchayati raj institutions (PRIs).

Swaran Jayanti Shahri Rozgar Yojana (SJSRY)

This scheme launched in December, 1997 and replaced by NULM (National Urban Livelihood Mission) in September 2013, aims to provide gainful employment to the urban unemployed and underemployed. The NULM will focus on organizing urban poor in SHGs, creating opportunities for skill development leading to market-based employment, and helping them set up self-employment ventures by ensuring easy access to credit. The mission aims at providing shelter with basic amenities to urban homeless. It also plans to address livelihood concerns of urban street vendors.

CHAPTER – 6

INDUSTRY

Performance of industrial sector has been lacklustre in recent years mainly because of contraction in mining activities and deceleration in manufacturing output. Further, slowdown in construction activities has also resulted in underutilisation of capacity in some of the core industries like steel and cement. There have even been constraints on the demand side as interest rates remained relatively higher resulting in the output of capital goods and consumer durables. The two key manufacturing sub-sectors viz. automobiles and gems and jewellery posted negative growth in 2013-14 and 2014-15 with some recovery signs in 2015-16.

The second half of fiscal year 2015-16 has shown signs of revival in investment as GDP rose by 7.4 per cent in July-September quarter (against 7 per cent in April-June quarter) helped by strong manufacturing which grew by 9.3 per cent against 7.2 per cent in the previous quarter – a sign that firms are producing more as sales show signs of picking up. Gross fixed capital formation which is a measure of investment activity increased to 30.6 per cent of GDP in July-September quarter from 29.8 per cent in the last quarter which shows that firms are adding new capacities.

However, performance of eight core sectors viz., coal, crude oil, natural gas, refinery products, fertilisers, steel, cement and electricity shows that they grew 2.5 per cent from April-October, 2015 which was much lower than 5.6 per cent in the same period last year. There has also been slowdown in construction and infrastructure sectors.

Industrial sector performance depends upon manufacturing sector as it accounts for nearly 60 per cent of the industrial sector. As against the poor performance of the Indian capital goods sector, the global performance has been robust. Globally the five fastest growing manufacturing sectors in recent years have been (i) basic metal (ii) radio, TV, and communications equipment (iii) office accounting and computing machinery, (iv) electrical machinery and apparatus, and (v) transport. Another area of concern is the sudden dip in imports of capital goods in recent years due to economic slowdown and rupee depreciation. The imports of machinery, electrical machinery, transport goods and electronic goods have declined in the last two financial years.

In order to instil confidence among the business community and boost industrial growth, some fresh initiatives have been taken by the government. The emphasis has been on rapidly improving ease of doing business and launching fresh initiatives like Make in India and Digital India, creating a National Industrial Corridors Authority, streamlining environment and forest clearance and a package of labour reforms. A brief write up of all these is given below:

- **Ease of Doing Business:** To improve India's low Ease of Doing Business Index ranking, reforms are being undertaken in areas such as starting a business, dealing with construction permits, registration of property, power supply, paying taxes, enforcing contracts, and resolving insolvency. The important measures that have been undertaken are liberalisation of licensing and deregulation of a large number of defence products, extending the validity of licenses to provide enough time to licences to procure land and obtain the necessary clearances/approvals from authorities, adoption of a checklist with specific time-lines for processing all applications filed by foreign investors in cases relating to retail/non-resident Indian (NRI)/export-oriented unit (EoU) foreign investments, automation of processes for registration with the Employees Provident Fund Organisation and Employees State Insurance Corporation, processing of environment and forest clearances online, reducing the number of documents for exports, adoption of best practices by states in granting clearances and ensuring compliance through peer evaluation, self-certification, etc.

- India has a long way to go to ease of doing business as India's rank in the latest Doing Business report of the World Bank released in October 2015 is 130 which is up from 142 last year. It takes as many as 33 procedures over 191 days in India to set up a warehouse as compared to 10 procedures in 26 days in Singapore.

- **Make in India:** The Make in India programme is aimed to facilitate investment, foster innovation, enhance skill development, protect intellectual property, and build best-in-class manufacturing infrastructure. Information on twenty-five sectors has been provided on a web portal along with details of FDI policy, National Manufacturing Policy, intellectual property rights, and the Delhi-Mumbai Industrial Corridor and other National Industrial Corridors. An Investor Facilitation Cell has been created in 'Invest India' to guide, assist, and handhold investors.

- **E-Biz Project:** Under the project a Government to Business (G2B) portal is being set up to serve as a one-stop shop for delivery of services to the investors and address the needs of the business and industry from inception through the entire life cycle of the business. The process of applying for industrial licence (IL) and industrial entrepreneur memorandum (IEM) has been made online and this service is now available to entrepreneur on 24 x 7 basis at the E-Biz website. Other services of the central government are being integrated on top priority.
- **Skill Development:** After the setting up of a new Ministry of Skill Development and Entrepreneurship to promote skill and entrepreneurial activities, work is being undertaken on setting up common norms for skill training across central ministries/ departments. Thirty-one industry/employer-led Sector Skill Councils (SSCs) are now operational and these have been aligned with the twenty-five sectors of 'Make in India'. To create a common standard for skills training and certification in the country efforts are on to align the National Council for Vocational Training (NCVT), school boards, and the University Grants Commission (UGC).
- **Streamlining environment and forest clearances:** A process for online submission of applications for environment, coastal regulation zone (CRZ), and forest clearances has been started. The decision-making process has been decentralised by strengthening federalism. To ensure industrial and education growth, the requirement of environment clearance has been done away with for projects for construction of industrial sheds which house plant and machinery, educational institutions and hostels.
- **Labour-Sector Reforms:** A Shram Suvidha portal has been launched for online registration of units, filing of self-certified, simplified, single online return by units, introduction of a transparent labour inspection scheme via computerised system as per risk-based criteria, uploading of inspection reports within seventy-two hours and timely redressal of grievances. A Universal Account Number has been launched facilitating portable, hassle-free, and universally accessible Provident Fund accounts for employees. The Apprentices Act, 1961 has been amended so as to make it flexible and attractive to youth and industry and an Apprentice Protsahan Yojana to support micro small and medium enterprises (MSME) in the manufacturing sector in engaging apprentices has been launched.

In infrastructure, the focus has been on resolving long-pending issues like pricing of gas, establishing processes and procedures for transparent auction of coal and minerals, and improving power generation and distribution. In railways, there have been several policy announcements such as 100 per cent foreign direct investment (FDI) to build a variety of rail infrastructure and new initiatives like bullet/semi-high speed trains and modernisation of stations and timely completion of major projects like Dedicated Freight Corridors being monitored closely. In the road sector efforts have been undertaken to resolve problems associated with projects which are yet to be completed and the National Highways and Infrastructure Development Corporation Ltd. has been set up for speedy implementation of highway projects in the north-east.

Industrial-Sector Performance based on Revised GDP Estimates

The new series of national accounts, revising the base year from 2004-05 to 2011-12 and applying changed methodology, whose details are not yet available, gives considerably improved estimates of growth in the industrial sector in 2012-13 and 2013-14 as compared to those based on the 2004-05 series. This is mainly due to much better performance in the mining and manufacturing sectors as per the new series. In 2013-14, manufacturing sector growth is estimated at 5.3 per cent as compared to the (-) 0.7 per cent estimated under the 2004-05 series. The Advance Estimates (AE) for the year 2014-15 show industrial growth of 5.9 per cent as per 2011-12 base year. The manufacturing, electricity, and construction sectors have grown remarkably while growth in the mining sector has declined as compared to 2013-14. The improved performance in manufacturing is attributed to the change in methodology and use of new data sources. The growth in electricity, gas, and water supply and construction shows marked improvement in 2014-15 as compared to the previous two years.

The 'Make in India' initiative launched in September 2014 with the aim of making India a global manufacturing hub has identified 25 focus sectors which include sectors like automobiles, aviation, chemicals, biotechnology, construction, defence manufacturing, electrical machinery, food processing, leather, media and entertainment, railways, roads and highways, space, etc.

Its main aim is to (a) encourage companies, both domestic and multinationals, to increase manufacturing in India (b) upgrade share of domestic manufacturing in GDP from 16 per cent to 25 per cent by 2022 and create 100 million additional jobs by 2022;

(c) faster innovation (d) protect intellectual property rights and (e) enhance skill development.

Some of the achievements and initiatives taken towards this end in the last one year have been as follows: (i) 100 per cent FDI allowed in all the 25 target sectors except space (75%) and defence (49%); (ii) improved ease of doing business by launching e-filing of IT returns and extension of the validation of industrial licences to 3 years; (iii) States are to be ranked on the basis of ease of doing business; (iv) labour reforms.

A total of 290 central public sector enterprises existed under the administrative control of various Ministries/Departments as on 31st March, 2014. Of these, 234 were operational and 56 under Construction. Financial investment in all these was nearly 10 lakh crores. Out of 234 operational enterprises, 163 were profit-making and 71 loss-making. Top five profit making enterprises were ONGC, Coal India, NTPC, IOC and Mineral Development Corporation. Top five loss-making were BSNL, Air India, Hindustan Photofilms Manufacturing Company, Hindustan Cables and State Trading Corporation.

Public Sector enterprises are mainly in the form of three categories viz., (1) Statutory Corporations (ONGC, NTPC, etc.), (2) Companies registered under the Companies Act and (3) Departmental Undertakings.

Economic reforms initiated in 1991 saw a substantial dilution in the role of public sector enterprises as many of the industries exclusively reserved for PSUs were also shared by the Private Sector. The most important of reforms in PSUs since 1991 has been the policy of disinvestment and privatisation to induct private sector acumen in PSUs and also to make available funds to the government to revive sick PSUs. There has also been the policy of MoUs signed between public sector enterprises and concerned ministries to set goals and targets and financial performance parameters. Since 1997, PSUs are being awarded special status depending upon their performance and importance for the economy. This status ensures financial and operational autonomy for them. There have been three such awards viz. Navratnas, Maharatnas and Mini-ratnas.

PSUs dominate in areas like petroleum, power generation, power transmission, heavy engineering, shipping and trading and storage and public distribution.

Policy of disinvestment began first of all in 1992 with very small percentage of shares of PSUs offloaded to the public. This did not pay off as it did not serve the purpose of inducting private sector initiative in PSUs. Subsequently, from 1996 the government started, a policy of strategic disinvestment under which up to 26 per cent shares could be sold to a strategic partner who would have genuine interest in running the enterprise on a day-to-day basis with this strategic stake. Disinvestment policy has been undergoing changes from time to time and new forms of disinvestment like Exchange Traded Funds and Offer for Sale have been adopted. There has also been the cross-holding format under which shares of a PSU are bought by other PSUs.

The government set up a Board for Reconstruction of PSUs in 2004 to address issues like modernising, restructuring of PSUs as well as revival of sick PSUs. A National Investment Fund has also been set up into which proceeds of disinvestment are given. The government wants state-owned enterprises (SOEs) to pay dividends of at least 30% of their profits after tax or of equity, whichever is higher, provided they would not scupper planned productive investment in the process. Cash hoards of SOEs should be commandeered by the government, to step up the investment the economy badly needs.

However, the government should not see squeezing dividends out of SOEs as an alternative to disinvestment. Weak market conditions are touted by the government as the reason for deferring stake sales. The spectacular show by Narayana Hrudayalaya after its initial public offering shows that good companies can fare well even in today's choppy market. The government can pursue the goal of democratising share-ownership, along with fiscal targets, by selling state-owned shares to the public at low levels of pricing, so long as the shares are widely distributed among retail investors.

The Fourteenth Finance Commission had looked askance at the tendency on the part of the SOEs to avoid leverage and rely on own funds. It makes perfect sense for under-leveraged SOEs to meet investment needs by borrowing from the market while passing on their surplus funds to the government, which will help it narrow its revenue deficit.

Micro, Small, and Medium Enterprises Sector

The 3.61 crore (MSMEs), contributing 37.5 per cent of the country's GDP, have a critical role in boosting industrial growth and ensuring the success of the Make in India

programme. A number of schemes are being implemented for the establishment of new MSMEs and growth and development of existing ones. These include: (a) the Prime Minister's Employment Generation Programme; (b) Micro and Small Enterprises-Cluster Development Programme; (c) Credit Guarantee Fund Scheme for Micro and Small Enterprises; (d) Performance and Credit Rating Scheme; (e) Assistance to Training Institutions, and (f) Scheme of Fund for Regeneration of Traditional Industries.

Manufacturing enterprises constitute 31.8 percent of the micro, small, and medium enterprises (MSME) sector and service enterprises account for the remaining 68.2 percent. About 55.3 percent of these enterprises are located in rural areas. The MSME sector showed consistent growth of more than 11 percent every year till 2010-11, whereas in 2011-12 the growth rate was 19 percent and in 2012-13 about 14 percent.

The Twelfth Plan covers various aspects of the MSME sector under six broad verticals: (i) finance and credit, (ii) technology, (iii) infrastructure, (iv) marketing and procurement, (v) skill development and training, and (vi) institutional structure. The Plan has a separate set of recommendations for the khadi and village industries and coir sectors.

In order to boost the MSME sector, several schemes are operational. Some of the major initiatives taken for the development of this sector are: (i) Technology Centre Systems Programme; (ii) India Inclusive Innovation Fund; (iii) Credit Linked Capital Subsidy; (iv) Credit Guarantee Scheme; (v) Prime Minister's Employment Generation Programme; (vi) MSE-Cluster Development Programme; and (vii) Scheme for Extension of non tax benefits to MSMEs for three years. The government has also notified the Public Procurement Policy for Micro & Small Enterprises (MSEs) Order 2012. The policy mandates that every central ministry/department/public sector-undertaking shall set a minimum annual procurement goal of 20 percent of total product and service purchases from MSEs from financial year 2012-13 onwards, in a period of three years. Further, the policy has also earmarked a sub-target of 4 percent of this 20 percent for MSEs owned by Scheduled caste (SC)/Scheduled tribe (ST) entrepreneurs.

In view of the dwindling share of the informal sector in overall manufacturing it is critical to strengthen the MSME sector. Rejuvenating small businesses both in the formal and informal sectors is crucial for generating employment opportunities for the teeming millions in the coming years. It is therefore imperative to focus on key drivers.

The informal/unregistered segments of manufacturing have been performing below potential due to lack of adequate and low cost financing, rising input costs, competition from imports, and an unfavourable business environment in general. The informal sector lacks easy access to credit and technology. The productivity gap between the informal and formal industry sectors remains large. The role of small businesses and the informal sector is of utmost importance in meeting employment-generation targets. Industrial policy needs to focus on labour-intensive and resource-based manufacturing in the informal sector. Growth of the informal sector and small businesses is constrained by a large number of laws, rules, and inspections. Operational compliances are required individually for almost all activities carried out by small businesses. Because of the regulatory and fiscal burden, small businesses tend to avoid becoming medium and formal.

The government is considering a proposal to include MSMEs into definition of start ups to help boost the Make in India campaign. The Start Up India initiative is scheduled to be announced in January 2016. To qualify as a start up, an entity would also have to meet certain financial standards besides having a level of innovation in its product or service.

State governments are formulating and implementing heterogeneous sets of regulations. Apart from inspections and compliances, insolvency provisions make it difficult to restructure and rehabilitate sick and dying businesses in the small and medium enterprises sector. Procedures to buy and acquire land are costly. Registration of land sale and purchase deeds, transfer of title, and acquiring of construction permits are complicated and time-consuming procedures. While some states have taken steps to promote ease of doing business in recent years, the majority of states are still far from having a friendly eco system for small businesses. There is need to build a consensus on best practices to be applicable to all states and to promote self-certification, e-filing, and e-returns.

The "Make in India" call and slogan by the government implies that the government is willing to open its doors to foreign investors who would utilise indigenous resources to enhance manufacturing in India. The government has raised FDI caps in defence production and insurance and also eased FDI in construction. It has also initiated a large number of labour reforms to relieve the small scale sector of Inspector Raj. A scheme was launched in April, 2015 called Pradhan Mantri Mudra Yojana – Micro

Units Development and Refinance Agency for funding the unfunded segments and facilitating small segment as per their requirements. Under the programme, mega credit campaigns are being organised all over the country to fund such enterprises and create a sound economic system subsequently by providing bank credit to aspiring entrepreneurs specially small and micro enterprises. The scheme has a target to cover up to 17.5 million small businesses by March, 2016. No bank guarantees are required under the scheme. Under the scheme, the government has approved the setting up of two credit guarantee funds to facilitate loans to micro and small enterprises through MUDRA and the Stand Up India scheme under which a refinance window would be provided through Small Industries Development Bank of India (SIDBI) with an initial amount of Rs. 10,000 crores. The Stand Up India scheme is distinct as its objective is to help entrepreneurs from scheduled castes and tribes and women entrepreneurs. Each branch of all banks, including private banks, will fund at least two entrepreneurs in the SC/ST category and one in women category. The government aims to refinance loans of Rs. 2 – 5 lakh borrowers in 36 months under the Stand Up India scheme. The credit guarantee fee under both the funds will be paid by the banks and not passed on to the borrowers.

The National Credit Guarantee Trustee Company Ltd (NCGTC) would be the trustee for both the credit guarantee funds of MUDRA as well as Stand Up India. The Stand Up India scheme will handhold borrowers both at the pre-loan stage and during operations. This would include increasing their familiarity with factoring services, registration with online platforms and e-market places as well as sessions on best practices and problem solving. Under the scheme, the margin money would be up to 25 percent, while remaining would be funded by the bank.

The credit guarantee fund for MUDRA is expected to guarantee more than Rs. 1 lakh crore worth of loans to micro and small units in the first instance. It will help in reducing risk taken by banks and financial institutions in case of default under the scheme. The government will provide guarantee on portfolio basis to maximum extent of 50 percent of the amount in default in portfolio.

The Cabinet has also approved conversion of MUDRA Ltd, currently a non banking finance company, into a bank called MUDRA-SIDBI Bank, a wholly owned subsidiary of SIDBI.

CHAPTER – 7

MONETARY POLICY AND BANKING

Monetary Policy is a policy adopted by the Central Bank of a country, in India the RBI. It is this policy which determines from time to time the adequacy or otherwise of the total money supply in the economy so as to achieve some macroeconomic objectives like price stability, economic growth, stabilisation of exchange rate, generating employment, equitable distribution and bringing about a balance between saving and investment. The principal tools of monetary policy are repo rate, cash reserve ratio, open market operations, bank rate and statutory liquidity ratio – called quantitative tools. Monetary Policy is also called Credit Policy and the two can be used interchangeably.

When Central Bank increases money supply/credit supply in the economy by using the above tools, it is called expansionary policy which may generally be adopted during a period of economic slowdown/recession with a view to kickstart the economy by pushing up demand and investment. On the other hand, during periods of high inflation, the Central Bank may adopt contractionary policy by raising key policy rates to tame inflation. The RBI announces its monetary policy every two months by way of monetary policy review.

RESERVE BANK OF INDIA (RBI)

The RBI was established under the Reserve Bank of India Act, 1934 on 1st April, 1935. It was nationalised on 1st January, 1949 as per RBI Nationalisation Act (1949). RBI is the Central Bank of the country and performs all those functions which Central banks of other countries perform. There are four financial institutions also under the regulation and supervision of RBI. These are Exim Bank, NABARD, SIDBI and NHB.

The monetary functions of the RBI include control and regulation of money and credit, control of foreign exchange operations, acting as banker to the Government, bankers' bank, and lender of the last resort.

The non-monetary functions of the RBI are related to the promotion of a sound banking system under which it is instrumental in supervising branch expansion, management and methods of working and regulation and control of the banking system as a whole.

The monetary policy of the RBI has a very important role to play in pushing up growth as this policy determines the amount of money and credit that will become available to various sectors of the economy. While adopting this policy, it has also to keep in mind that money supply does not exceed genuine demands of various sectors and leads to inflation. To strike a balance between the two objectives of pushing growth on the one hand and containing inflation on the other, the RBI has all along followed a policy of 'Controlled Expansion' which implies that money supply is expanded to meet only the genuine requirements of various sectors, taking a caution that it does not spill over to cause inflation. This principle has also guided its policy of exercising control over the creation of credit by commercial banks. The RBI, like any other Central Bank, uses the following two principal measures of credit control:

(1) Quantitative Credit Control Measures

(2) Qualitative or Selective Credit Control Measures

Quantitative Controls: These are controls designed to regulate the overall volume of credit created i.e. loans given by banks. The principal instruments used under these controls are as follows:

(i) **Bank Rate**: It is that rate of interest at which the RBI provides refinancing facilities to commercial banks by rediscounting their bills of exchange or other commercial papers. It is the rate at which the RBI extends long term credit to commercial banks. The Bank Rate at present is 7.75 percent as it is aligned to the MSF rate.

(ii) **Cash Reserve Ratio**: The RBI Act, 1934 stipulates that a commercial bank is required to keep a certain percentage of its total deposits with the RBI in cash. The RBI can vary this percentage. As such, this is also called Variable Reserve Ratio. This ratio at present is 4 percent. Generally, the RBI permits Banks to maintain minimum daily average holding of 70 percent of the mandated 4 percent CRR. However, it can tighten this requirement depending upon changed economic conditions. This ratio helps in increasing or squeezing liquidity in the system.

(iii) **Statutory Liquidity Ratio**: It is that ratio/percentage of its total deposits which a commercial bank has to maintain with itself at any given point of time in the form of liquid assets like cash in hand, current balances with other

banks, gold or first class securities (generally government securities). This ratio at present is 21.5 percent.

(iv) **Open Market Operations**: These are operations which involve the sale and purchase of government securities by the RBI vis-a-vis the banking system. These operations not only help in stabilising the prices of government securities but more importantly, controlling the inflationary pressures from time to time as well as increasing/decreasing the supply of money. The RBI uses this tool on a regular basis to adjust liquidity. These operations are generally conducted by way of auction.

Repo and Reverse Repo

REPO means repurchase options – This is a policy tool under which the RBI purchases government securities from Banks for overnight or for a few specified days (7, 14 or 21) and lends them against these securities for this specified period with a condition that banks will repurchase these securities from the RBI after that period. Essentially therefore, REPO implies short term lending to banks by RBI against government securities. These securities should, however, be over and above the SLR. There is a limit fixed by the RBI for such borrowings as a percentage of a bank's total deposits. The rate at which it lends is called Repo Rate which has been reduced from 7.25 per cent to 6.75 per cent w.e.f. 29th September 2015.

REVERSE REPO means that the RBI borrows from banks by selling them government securities for a short period (as under REPO) with an in-built clause that the RBI will repurchase these securities from banks after that period. The rate at which banks lend to the RBI is called Reverse Repo Rate which at present is 5.75 per cent.

Both Repo and Reverse Repo are used by the RBI to adjust short term liquidity under RBIs Liquidity Adjustment Fund (LAF).

Qualitative or Selective Credit Controls are controls designed to regulate both the volume of loan and the purpose for which loans are given by commercial banks. The techniques of Selective Credit Controls are minimum margins for lending against specific securities, ceiling on the amount of credit for specific purposes (called rationing of credit) and discriminatory rates of interest charged on certain types of advances. Through selective credit controls, the RBI tries to maintain sectoral and regional balance. Selective controls also include exercising its moral suasion by the RBI over banks and,

as a last resort, taking direct action by way of punitive measures. Selective controls have special importance in India to check speculation and hoarding by traders on the basis of loans taken from banks.

Marginal Standing Facility (MSF)

In May 2011, the RBI introduced a new 'instrument' called the Marginal Standing Facility under which all Scheduled Commercial banks can avail from the RBI overnight funds up to a certain per cent of their net demand and time liabilities. The facility can be availed at an interest rate which would be one percent above the prevailing repo rate or as decided by the RBI from time to time. The RBI has aligned the Bank Rate with the MSF rate. Henceforth, whenever there is an adjustment of the MSF rate (based on the prevailing repo rate) the RBI will align the Bank Rate with the revised MSF rate. The MSF rate at present is 7.75 percent which is one per cent higher than the Repo Rate. MSF can be availed by banks against government securities even within the SLR limit.

MONEY SUPPLY

The RBI initiated publication of a new set of monetary and liquidity aggregates as per the recommendations of the 'Working Group on Money Supply, Analytics and Methodology of Compilation'. While no changes were made in the definitions of M_0 and M_1 new monetary aggregates NM_2 and NM_3 as well as liquidity aggregates L_1, L_2 and L_3 have been introduced, the components of which are elaborated as follows:

NM_1 = Currency with the Public + Demand Deposits with the Banking System + Other Deposits with the RBI.

NM_2 = NM_1 + Short Term Time Deposits of Residents (including and up to the contractual maturity of one year).

NM_3 = NM_2 + Long-term Time Deposits of Residents + Call/Term Funding from Financial Institutions.

L_1 = NM_3 + All Deposits with the Post Office Savings Banks (excluding National Savings Certificates).

L_2 = L_1 + Term deposits with Term Lending Institutions and Refinancing Institutions (FIs) + Term Borrowing by FIs + Certificates of Deposit issued by FIs.

L_3 = L_2 + Public Deposits of Non-banking Financial Companies.

Data on M_0 are published by the RBI on weekly basis, while those for M_1 and M_3 are available on fortnightly basis. Among liquidity aggregates, data on L_1 and L_2 are published monthly, while those for L_3 are disseminated once in a quarter.

M_0 denotes reserve money i.e. money created by the RBI and Government of India. It is also called high powered money which is expressed as follows: -

M_0 = C + CR of banks kept with RBI + OD with RBI

BASE RATE

The concept of Base Rate was introduced w.e.f. 1st July, 2010 replacing the age-old PLR and the Benchmark PLR.

The base rate is the floor rate below which a bank cannot lend even to its top-most client and is arrived at after factoring in a bank's cost of funds and other operating expenses. It replaces the much-abused benchmark Prime Lending Rate (PLR). Base rate will be the reference rate over which all loans will be priced.

A Central Bank Panel recommended the new system after finding that banks, mostly private sector ones, were not passing on the reduction in policy rates to customers while they were quick to act whenever rates climbed. That blunted monetary policy transmission. The lack of transparency in lending also led to accusations that small companies and retail customers were subsidising the so-called AAA customers.

Base rate is determined by a bank on the basis of its costs which include cost of deposits, profit margins, operating expenses, administrative expenses and statutory expenses. Base rate does not apply to concessional loans for agriculture, exports and other specified sectors. Base rate implies that small customers will no longer subsidise the bigger ones. It will ensure that rate hikes or cuts are informally passed on to all borrowers. The RBI has directed banks to fix their Base Rate on the basis of marginal cost rather than average cost so that there is better transmission of monetary policy.

This implies that every bank will fix its monthly base rate depending upon deposits that it receives from public every month rather than average deposits in the last few months.

Treasury Bills

Treasury Bills (TBs) are a short-term liability of the Government of India. Except the RBI, there are no major holders of TBs. Non-bank financial intermediaries, corporate

firms, etc., do not hold TBs. Treasury bills are basically of two types: ad hoc and regular. Ad hoc means 'for the particular end or case in hand'. The issue of ad hoc treasury bills had begun to represent automatic monetisation of the government's budget deficit. Therefore, as a measure to contain this trend, the system of ad hoc treasury bills was discontinued from 1997-98. (The Ways and Means Advances replaced the ad hoc bills for financing government's temporary deficits.) Treasury bills are of various maturities:

91-Day Treasury Bills: The 91-day treasury bills have been the traditional instrument in the money market through which the government raises funds for short periods and commercial banks invest their short term funds. Also, there are 182-day Treasury Bills.

364-Day Treasury Bills: The 364-day treasury bills, being long-dated and relatively risk-free, attract investments from banks and financial institutions. These can be easily liquidated in times of need and are superior to other investments. The 364-day treasury bills have become an important instrument of Government borrowing from the market. These bills are entirely held by the market and the RBI does not subscribe to them.

COMMERCIAL BANKS AND INDIA'S BANKING SYSTEM

Commercial banks are major constituents of India's money market which means market for borrowing and lending of short-term funds as distinct from 'capital market' which deals in long-term funds. When banks and financial institutions deal in short term funds they are called constituents of the money market and when they deal in long-term funds they are constituents of the capital market.

Indian money market has two segments viz., the Organised money market which consists of all commercial banks, co-operative banks and regional rural banks and the Unorganised money market which consists of indigenous bankers, money lenders, shroffs, Mahajans, Baniyas etc. who lie outside the purview of the RBI.

Call Money Market means inter-bank transactions on a day-to-day basis. It is also known as 'money at call and short notice' which implies that, on a day-to-day basis, banks which have surplus funds lend to those which are short of funds. The rate of interest at which those day-to-day transactions between banks take place is known as the **'Call Money Rate'.** This is the most sensitive segment of the money market. A high call money rate would mean scarcity of funds and tight money market while a low call rate would mean easy availability of funds. Mumbai being India's financial hub, the call money rate in the Indian money market is determined on the basis of MIBOR (Mumbai

Interbank Offered Rate) - a term coined on the lines of LIBOR - the London Interbank Offered Rate.

The most important constituent of the organised money market in India are the commercial banks, both in the public as well as the private sector including foreign banks. At present, there are 27 commercial banks in India in the public sector consisting of 19 nationalised banks, the State Bank of India, five subsidiary banks of the SBI, the IDBI and the Bhartiya Mahila Bank.

A commercial bank can be a Scheduled bank or a non-scheduled bank. A Scheduled commercial bank is a bank which has a paid-up capital of Rs. 5 lakhs and above and which is listed in the Second Schedule of the RBI Act, 1934. Such a bank must carry out its activities in the interest of the depositors and as such it is eligible for RBI patronage.

A non-scheduled bank, on the other hand, is one which is not included in the Second Schedule of the RBI Act, 1934. Such banks do not enjoy the patronage of the RBI and thus cannot enjoy refinancing facilities of the RBI.

The first purely Indian Commercial Bank set up in India was the Punjab National Bank in 1894. However, the Oudh Commercial Bank set up in 1881 with limited Indian equity was the oldest commercial bank set up in India. The State Bank of India is the largest public sector bank in the country. It was set up in 1921 by amalgamating the Presidency banks of Bengal, Bombay and Madras and was then known as the Imperial Bank of India. It was nationalised in 1955 and named as State Bank of India. It works as an agent of the RBI wherever RBI does not have a branch.

Nationalisation of Banks - In July 1969, the Government of India passed the ordinance for nationalisation of such of the 14 major commercial banks in India which had total deposits of Rs. 50 crore and above. Six more banks were subsequently nationalised in 1980. These were banks having total deposits of Rs. 200 crore and above.

Nationalisation of the banking industry was carried out to achieve a large number of objectives as follows:

(i) to prevent concentration of economic power, as banks in the private sector mostly provided credit to a small class of high-profile customers and those industries in which banks' shareholders had their interests;

(ii) to spread banking across the length and breadth of the country and correct the urban bias;

(iii) to cater to the requirements of the agricultural sector and reduce the stranglehold of the money lenders;

(iv) to make banking industry serve social purposes as against profit maximisation;

(v) to develop a pool of professional bankers;

(vi) to mobilise savings of a large mass of population, as nationalisation would instil confidence among the people.

A large number of benefits have accrued to the economy since the nationalisation of banks. There has been massive spread of bank branches, sharp rise in mobilisation of deposits and credit disbursement to priority sector like agriculture, small-scale industries, sick units, social orientation of banking industry in terms of financing poverty alleviation and employment generation programmes, diversification of banking operations by way of merchant banking, housing finance, leasing, off-shore financing etc. The banking industry has been transformed from 'class banking' to 'mass banking' and has resulted in fast spread of banking habits.

However, nationalisation of the banking industry also brought with it, over the years, a large number of problems which eroded the financial base and credibility of the entire banking industry. Problems like uneconomic branch expansion, directed credit programmes, violation of prudential norms of banking, lack of transparency in preparing balance sheets, over-staffing, declining customers service, rampant political interference in their day to day functioning, loan melas, loan waivers etc. brought the banking industry to a situation when as many as 14 out of 20 nationalised banks were reported sick in 1991. Priority sector lending along with stipulations of maintaining high CRR and SLR imposed by the RBI dealt final blows leading to mounting losses and high non-performing assets of the banking sector. Reforms in the banking industry became inevitable at this point of time. Hence, with the announcement of the New Economic Policy in 1991, reforms of the banking sector were triggered by setting up the Narasimhan Committee on Financial Sector Reforms in 1991.

BANKING REFORMS

Narasimhan Committee Recommendations: The Committee on Financial Sector Reforms headed by Mr. M. Narasimhan (1991) recommended a large number of measures to reform the banking and financial sector. Major recommendations of the Committee were as follows:

(i) There should be no bar to new banks being set up in the private sector, provided they conformed to the start-up capital and other requirements prescribed by the Reserve Bank of India.

(ii) The Government should indicate that there would be no further nationalisation of banks and there should not be any difference in treatment between public sector banks and private sector banks.

(iii) The banking system should evolve towards a broad pattern consisting of three or four large banks, including the State Bank of India, which could become international in character; eight to ten national banks with a network of branches throughout the country engaged in universal banking; local banks whose operations would be generally confined to a specified region and lastly, rural banks to cater to rural areas.

(iv) There should be an Assets Reconstruction Fund (ARF) which could take over from the banks and Financial Institutions (FIs) a portion of their bad and doubtful debts at a discount, the level of discount being determined by independent auditors on the basis of clearly defined guidelines. The ARF, according to the Committee, should be provided with special powers for recovery, somewhat broader than those contained in sections 29 to 32 of the State Financial Corporation Act, 1951. The capital of the ARF should be subscribed by the public sector banks and the financial institutions.

(v) The banks and the financial institutions should be authorised to recover DRTs bad debts through the special tribunals and based on the valuation given in respect of each asset by a panel of at least two independent auditors.

(vi) The public sector banks with profitable operations should be allowed to tap the capital market for enhancement of their share capital. Subscribers to such issues could be mutual funds, profitable public sector undertakings and the employees of the institutions besides the general public.

(vii) Branch licensing should be abolished and the option of opening branches or closing of branches other than rural branches for the present, be left to the commercial judgement of the individual banks. Further, the internal organisation of banks is best left to judgement of the management of the individual banks.

(viii) There should be phased reduction of CRR and SLR.

(ix) A Board for Financial Supervision should be set up to oversee the operations of the banks.

(x) Banks should conform to prudential income-recognition norms of provisioning against bad and doubtful debts and ensure transparency in maintaining balance sheet.

(xi) There should be speedy computerisation of the banking industry.

(xii) There should be no further branch expansion.

(xiii) Banks should enjoy the freedom to close a branch, except those in rural areas.

The Committee also recommended that foreign banks should be subjected to the same requirements as are applicable to the Indian Banks and RBI policies should be more liberal in respect of allowing the foreign banks to open branches or subsidiaries. Joint ventures between foreign banks and Indian banks should also be permitted particularly in regard to merchant banking, investment banking, leasing and other newer forms of financial services. Priority sector lending by banks should be reduced from 40 percent to 10 percent of their total credit.

The Committee recommended phasing out of concessional interest rates. The Committee was of the view that the present structure of administered interest rates was "highly complex and rigid" and proposed that interest rates be further deregulated so as to reflect emerging market conditions. Premature moves to market determined interest rates could, as experience abroad has shown, pose the danger of excessive bank lending at highly nominal rates to borrowers of dubious credit worthiness, the committee observed.

Most of the recommendations of the Committee have since been implemented. Meanwhile, keeping in view the changing global scenario after the setting up of the WTO

and the need for more efficient, competitive and broad-based banking sector, the Government set up another Committee on Banking Sector Reforms under the Chairmanship of Narasimhan.

Narasimhan Committee-II Recommendations

The Narasimhan Committee on banking sector reforms submitted its report in April 1998 and made a series of sweeping recommendations. The report covers an entire gamut of issues ranging from bank mergers and the creation of globalised banks to bank closures, recasting bank boards and revamping banking legislations. The Committee makes a case for a stronger banking system in the country, especially, in the context of Capital Account Convertibility. Major recommendations of the Committee were as follows:

1. Merger of strong banks which have a multiplier effect on industry. It cautioned against merger of strong banks with weak banks as this will adversely affect the asset quality of strong banks.
2. Concept of narrow banking should be tried out to rehabilitate weak banks. If this was not successful, the issue of closure should be examined. Narrow banking, according to the Committee, implied that weak banks should not be permitted to invest their funds anywhere except in government securities as these were absolutely safe and risk free.
3. Two or three large Indian banks should be given international character.
4. Small, local banks should be confined to States or cluster of districts in order to serve local trade, small industry and agriculture.
5. The Committee also commented on the Government's role in public sector banks by observing that Government ownership has become an instrument of management. Such micro-management of banks is not conducive to enhancement of autonomy and flexibility.
6. Functions of boards of management need to be reviewed so that the boards remain responsible for enhancing shareholder value through formulation of corporate strategy.
7. Need to review minimum prescriptions for capital adequacy. In this regard, the Committee recommended that CAR be raised to 10 percent by 2002.

8. The RBI Act, Bank Nationalisation Act, Banking Regulation Act and State Bank of India Act were in urgent need of review.
9. Legal framework of loan recovery should be strengthened.
10. Integration of NBFC's lending activities into the financial system.
11. Need for public sector banks to speed up computerisation and focus on relationship banking.
12. Review of recruitment procedures, training and remuneration policies in public sector banks.
13. Setting up of a Board for Financial Supervision for banks, financial institutions and NBFCs.
14. Need for professionalising and depoliticising of bank boards.
15. The Banking Service Recruitment Boards should be abolished.
16. The RBI should act only as a regulator and not both regulator and owner.

The recommendations of the Committee continue to be implemented in a phased manner. For example, Capital Adequacy requirements of banks have been stepped up and prudential norms have been made more and more stringent. All the major banking legislations viz., the RBI Act (1934), the Banking Regulation Act (1949), Bank Nationalisation Act (1970) have been reviewed and gradually diluted in accordance with changing requirements. More flexibility is being provided to banks by greater autonomy to bank boards. On-line banking has become the key word and consolidation of the banking industry (rather than branch expansion) is being encouraged by permitting mergers and acquisitions within the existing legal framework. Asset Reconstruction Funds/Companies have been set up for bad debts and the FDI limit in private banks has been raised to 74 percent. Most importantly, a securitisation legislation has been put in place for recovery of bad debts. This is known as SARFAESI viz., Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests. In October, 2011, the Union Cabinet approved the introduction of a new bill in Parliament to amend SARFAESI (2002) and Recovery of Debts Due to Banks and Financial Institutions (1993) to enable banks to improve their operational efficiency, deploy more funds for credit disbursement to retail investors, home loan borrowers and corporates without worrying

over the recovery process. Thus, the amendments would strengthen the ability of banks to recover dues from borrowers and reduce the level of their NPAs.

With liberalisation and growing integration of the Indian financial sector with the international market, the supervisory and regulatory role of RBI has become critical for the maintenance of financial stability. RBI has been continuously fine-tuning its regulatory and supervisory mechanism in recent years to match international standards.

The RBI has emphasised transparency, diversification of ownership and strong corporate governance practices to mitigate the prospects of systemic risks in the banking sector. The RBI has issued detailed draft guidelines on the sale/purchase of non-performing assets where securitisation companies and reconstruction companies are not involved.

Expansion of the banking sector is envisaged by issuing fresh banking licences to Private Sector players to achieve the goal of financial inclusion. The RBI issued guidelines for fresh banking licences which, inter alia, require a minimum capital of Rs. 500 crore and at least 25 percent of the branches to be set up in rural areas.

Based on the recommendations of the Committee set up under Bimal Jalan to screen applications for fresh banking licences, the RBI has granted banking licence to two new entities viz. Bandhan Financial Services and Infrastructure Development Finance Company (IDFC) to set up banks.

Non-performing assets of the banking sector

The deteriorating asset quality of the banking sector has emerged as a major concern in recent years as gross NPAs of banks have registered a sharp increase to nearly 5 per cent of the total advances in 2014-15. The deterioration in asset quality was most perceptible for the State Bank of India (SBI) Group.

Because of economic slowdown, global slowdown and high levels of leverage, some industry and infrastructure sectors, namely textiles, chemicals, iron and steel, food processing, construction, and telecommunication are experiencing a rise in NPAs. While there has been an across-the-board increase in NPAs, the increase has been particularly sharp for the infrastructure sector.

The RBI in its Financial Stability Report has identified five sectors – infrastructure, iron and steel, textiles, aviation, and mining – as the stressed sectors.

PSBs have high exposures to the 'industry' sector in general and to such 'stressed' sectors in particular. Increase in NPAs of public sector banks is mainly accounted for by slowdown of economic growth, aggressive lending by banks in the past, global slowdown, high interest rates, absence of bankruptcy law, slow judicial process, political pressure, kickbacks and commissions, etc.

A major problem in the way of recovery of toxic loans in India is the weak legal system which makes borrowers feel that it is their divine right to stay in control, despite mounting debts that they owe to banks. Defaulting borrowers often exercise political influence, kickbacks and commissions to senior officers of banks and such other tactics to delay repayment of loans. Even when cases are referred by banks to Debt Recovery Tribunals, these tribunals find that the quality of assets pledged by borrowers and their value is grossly insufficient to cover bad debts. Even personal sureties given by borrowers are found to be such that the borrowers have the last laugh.

The RBI has been particularly proactive to direct banks to identify wilful defaulters and initiate criminal proceedings against them. Nearly 20 percent of the gross NPAs of banks are of wilful defaulters. Also, the RBI has in recent months identified another category of defaulters called non-co-operative borrowers who adopt various ways to thwart recovery of loans.

An expert Committee set up Finance Ministry has proposed that those borrowers accused of wilful default should face the prospect of being put on trial within 30 days of a bank determining that a borrower was not paying despite being able to. Some other suggestions of the Committee include summary trials under which however, no sentence of imprisonment for a term exceeding three months can be passed, as these trials are meant to act as deterrents. Wilful defaulters lose access to capital markets and cannot access more loans from banks or financial institutions. The lenders can also initiate criminal proceedings against wilful defaulters but there is no legal backing for speedy recovery of dues.

Some other measures proposed to address the problem of NPAs include amendments of SARFAESI Act and RDDB Act (Recovery of Debts Due to Banks and Financial Institutions), setting up of six more DRTs and the proposed setting up of a national level Asset Reconstruction Company which would be vested with special powers to recover bad loans.

Banking Sector Reforms in the last two decades have focussed on adoption of Basel norms (Basel-III from 2010), debt recovery tribunals, asset reconstruction and securitisation companies under the SARFAESI Act. Absence of Bankruptcy Law is a major issue in this regard as medium and large companies often refer themselves to BIFR (Board for Industrial and Financial Reconstruction) as soon as they fall sick. It takes years for BIFR to revive them and during this period they cannot be touched by any court. Once Bankruptcy Law is passed, such companies can only be given a limited period for revival failing which they have to declare themselves bankrupt so that their assets are for sale in the open market.

BASEL NORMS

These are norms of sound banking practices laid down by the Basel Committee on Bank Supervision located at Basel, Switzerland. This Committee operates under the auspices of the Bank for International Settlement (BIS) located in Basel which acts as Central bank of Central banks, of which the RBI is also a member. Basel norms comprise of various parameters like liquidity, asset quality, capital adequacy, risk-weight, market-risk, operational risk, supervision, management etc. These norms were first laid down in 1988 under Basel accord in the form of BASEL-I subsequently migrating to BASEL-II by beginning of 21st century.

One of the most important parameters of sound banking in these norms is the concept of Capital Adequacy Ratio which is defined as the ratio of total free, unencumbered capital of a bank to its risk-weighted assets. This ratio ensures that a bank has sufficient capital of its own to absorb a reasonable degree of losses and protects interests of depositors. A CAR of 10 for example would imply that if the total loans and advances of a bank amount to Rs. 100, it must maintain free capital of its own of Rs. 10. This ratio can be expressed as follows: -

$$CAR = \frac{\text{Total free capital (Tier I + Tier II)}}{\text{Risk weighted assets}}$$

BASEL- III

In the backdrop of the global financial meltdown, the Basel Committee on Banking Supervision has decided to introduce Basel-III norms to strengthen existing capital requirements and introduce a global liquidity standard to enable banks to weather financial storms. Basel-III introduced in 2010 mandates banks to increase the loss-

absorbing capital from 2 percent to 4.5 percent of risk-weighted assets by January, 2015. In addition, banks will be required to hold a capital conservation buffer of 2.5 percent to withstand future periods of stress, bringing the total loss-absorbing capital to 7 percent.

Capital conservation buffer of 2.5 percent is to be maintained by March 2018 consisting of common equity to protect the banking sector from periods of excess aggregate credit growth. These capital requirements are to be supplemented with a non risk based leverage ratio that will serve to back stop the risk based majors and higher capital norms. Basel-III will thus triple the quantum of capital which banks will be required to maintain.

Basel III represents an effort to fix the gaps and lacunae in Basel II that came to light during the financial meltdown. While Basel III does not jettison Basel II; it actually builds on the essence of Basel II - the link between the risk profiles and capital requirements of individual banks.

The enhancements of Basel III over Basel II come primarily in four areas:

(i) augmentation in the level and quality of capital;

(ii) introduction of liquidity standards;

(iii) modifications in provisioning norms; and

(iv) better and more comprehensive disclosures.

The minimum total capital remains unchanged at 9 percent of risk weighted assets. However, Basel III introduces a capital conservation buffer of 2.5 percent of RWA over and above the minimum capital requirement. This is to ensure banks absorb losses and not breach minimum capital need.

In order to meet enhanced capital requirements of BASEL III, public sector banks would require nearly four lakh twenty thousand crores of additional capital, most of which would be Tier I capital, by March, 2019 which is the deadline set by RBI. The RBI has proposed that additional capital to meet BASEL III norms can be raised by issuing non-voting rights share capital, differential voting rights capital and golden voting rights share capital. Also, it has proposed that banks could also float long-term bonds.

The government announced a major programme in September, 2015 to revamp public sector banks. The programme called 'INDRADHANUSH' comprises seven point programme as follows:

(1) Rs.70,000 crore will be provided to public sector banks in the next four years to meet BASEL III norms, out of which Rs. 25,000 crore shall be given during 2015-16.

(2) Top private sector talent will head some of the public sector banks – to begin with Canara Bank and Bank of Baroda.

(3) A Banking Boards Bureau will be set up to oversee middle and top level appointments in public sector banks.

(4) A Scheme of ESOP (Employee Stock Option Plan) will be introduced in public sector banks.

(5) There shall be more frequent monitoring of the performance of public sector banks.

(6) Governance parameters will be strengthened.

(7) There will be greater flexibility in hiring employees.

According to Economic Survey 2014-15, India's banking sector is afflicted with "double financial repression" due to three factors viz., SLR, priority sector lending and inflation. The first two adversely impact assets of banks while the third one viz., inflation affects their liabilities in the sense that high rate of inflation makes bank deposits unattractive as interest on these deposits may yield a negative return which results in people depositing lesser money in the banks.

Financial Sector Legislative Reforms Commission

With a view to revamping financial-sector laws to bring them in tune with current requirements, the GoI set up the Financial Sector Legislative Reforms Commission (FSLRC) in March 2011 which submitted its report in 2013. The FSLRC has given wide-ranging recommendations on the institutional, legal, and regulatory framework, and operational changes in the Indian financial sector. Broadly, the recommendations of the Commission can be divided into two parts, legislative and non-legislative aspects.

The legislative aspects of the recommendations relate to revamping the legislative framework of the financial-sector regulatory architecture through a non-sectoral, principle-based approach and by restructuring existing regulatory agencies and creating new agencies wherever needed. The Commission has recommended a seven-

agency structure for the financial sector. The non-legislative aspects of the FSLRC recommendations are broadly in the nature of governance-enhancing principles for enhanced consumer protection, greater transparency in the functioning of financial-sector regulators in terms of their reporting system, greater clarity on their interface with the regulated entities, and greater transparency in the regulation making process by means of mandatory public consultations, incorporation of cost-benefit analysis, etc.

These recommendations encompass issues relating to consumer protection, consumer protection for retail customers, timeline for regulations on consumer protection, requirements for framing regulations, notices to regulated entities, transparency, transparency in Board meetings, reporting, approvals, investigation, adjudication, imposition of penalty, and capacity building.

Financial Stability and Development Council

With a view to strengthening and institutionalizing the mechanism for maintaining financial stability, enhancing inter-regulatory coordination, and promoting financial-sector development, the government set up an apex-level Financial Stability and Development Council (FSDC) in December 2010. The Council is chaired by the Finance Minister and has heads of financial-sector regulatory authorities, the Finance Secretary and/or Secretary, Department of Economic Affairs, Secretary, Department of Financial Services, and the Chief Economic Advisor as members. The Council monitors macro-prudential supervision of the economy, including functioning of large financial conglomerates, and addresses inter-regulatory coordination and financial-sector development issues. It also focuses on financial inclusion and financial literacy.

Financial Stability Board

The Financial Stability Board (FSB) was established in 2009 under the aegis of the G20 bringing together the national authorities, standard-setting bodies, and international financial institutions to address vulnerabilities and to develop and implement strong regulatory, supervisory, and other policies in the interest of financial stability. India is an active Member of the FSB. The FSDC Secretariat in the Department of Economic Affairs coordinates with the various financial sector regulators and other relevant agencies to represent India's views with the FSB. As a member of the FSB, Basel Committee on Banking Supervision (BCBS), and International Monetary Fund (IMF), India actively participates in post-crisis reforms of the international regulatory and

supervisory framework under the aegis of the G20. India remains committed to adoption of international standards and best practices, in a phased manner and calibrated to local conditions, wherever necessary.

FINANCIAL INCLUSION

Financial inclusion means 'right to bank' which implies that every individual living in the remotest of the remote areas of the country has access to banking facilities by way of opening a deposit account and access to credit facilities.

In global parlance, financial inclusion also includes not only 'right to bank' but also 'right to insurance'. In India, just over 40 percent of the population has access to banking so that majority of the population is deprived of any banking product. This itself poses a serious challenge to achieving inclusive growth as financial inclusion is necessary for inclusive growth.

The RBI has adopted various measures to achieve financial inclusion like relaxation of KYC norms, opening of no-frills accounts, adoption of electronic benefit transfer, use of technology, opening of bank branches in unbanked areas, granting general permission to banks to freely open branches in tier III and tier IV centres with a population of less than 50,000 laying down a road map for providing banking services in unbanked villages having population of more than 2000.

The key to financial inclusion is the use of technology. In this regard, Kenya and South Africa are outstanding examples of countries which have achieved financial inclusion on the strength of technology whereby a mobile service provider has a tie up with a bank.

Detailed Strategy and Guidelines on Financial Inclusion were circulated to banks since October 2011 which inter-alia provide emphasis on : (i) setting up more brick and mortar branches with the objective to have a bank branch within a radial distance of 5 km; (ii) to open bank branches by Sept. 2012 in all habitations of 5,000 or more population in under banks districts and 10,000 or more population in other districts;(iii) to provide a Business Correspondent within a radial distance of 2 km; (iv) to cover villages of 1,000 and more population in 10 smaller States/UTs by September 2012; (v) to consider Gram Panchayat as a unit for allocation of area under Service Area Approach to bank branch and BC etc.

Banks have also been advised to transfer subsidies through Electronic Benefit Transfer (EBT) under 32 schemes which are in operation and funded by the Government of India, so that benefit gets credited directly to the account of the beneficiaries.

The 'Swabhiman Scheme' was launched in early, 2011 under which banks have to reach the beneficiary rather than the beneficiary travelling to the bank using various models and technologies including branchless banking through business correspondents and use of biometrics. Swabhiman has been extended to habitations with population more than 1,000 in the north-eastern and hilly states and population more than 1,6000 in the plains areas as per census 2001.

The RBI's guidelines for new bank licences have also been issued to further the cause of financial inclusion. These guidelines stipulate that corporates and public sector entities with sound credentials and a minimum track record of 10 years can enter the banking business. Promoters cannot directly set up a bank and will have to first float a 100 percent holding company which will hold the bank. At least 25 percent branches must be in rural unbanked areas. In April 2014 the RBI granted 'in-principle' approval to IDFC Ltd. and Bandhan Financial Services Pvt. Ltd. to set up banks under the guidelines.

The RBI set up a Committee on Comprehensive Financial Services for Small Businesses and Low-Income Households (CCFS) in 2013 under Dr. Nachiket Mor, Deputy governor, RBI. The Committee gave its report in 2014.

At its core, the Committee's recommendations are that in order to achieve the task of financial inclusion in a manner that enhances both financial inclusion and stability, there is need to move away from an exclusive focus on any one model to an approach where multiple models and partnership are allowed to thrive, particularly between national full-service banks, regional banks of various types, NBFCs, and financial markets. The common theme of all the recommendations made by the Committee is that instead of focusing only on large generalist institutions, specialisation and partnership between specialists must be encouraged. Such an approach, in its view, would be far more effective at delivering high quality financial inclusion, without compromising financial stability or responsibility towards customers.

In this regard, the Committee has recommended setting up of special category banks like small banks and payment banks with narrow and focussed clientele which has

remained, outside the ambit of large and universal banks. Based on these recommendations, the RBI issued guidelines for small banks and payment banks in 2014.

These guidelines will allow a host of new businesses such as mobile phone companies, supermarket chains and prepayment card issuers (Telcos) to set up specialised banks offering limited financial services to further financial inclusion.

The guidelines lay down a minimum Rs. 100 crore paid-up equity capital out of which 40 percent must be promoters' initial contribution to capital. There will be a ceiling on deposits up to one lakh per customer which a Payments Bank can accept initially. Payment banks can accept deposits and remittances but cannot lend. Existing non-bank pre-paid payment instrument issuers, NBFCs, corporate business correspondents, mobile telephone companies, super market chains, realty sector cooperatives and public sector entities can all apply for a licence for these banks. Also, micro finance institutions, NBFCs, and local area banks can convert into small finance banks.

Small finance banks are aimed at giving loans to 'unserved and underserved sections' including small business units, small and marginal farmers, and micro and small industries, unorganised sectors. The basic objective is to extend the range of financial services to the hitherto unbanked which were forced to rely on non-regulated means – money lenders, chit funds, cash transfers, etc. A small finance bank will be eligible to transit into a universal bank subject to several conditions such as its track record as a small finance bank, minimum paid-up capital norms applicable to universal banks plus RBI due diligence.

Resident individuals or professionals with at least 10 years of experience in banking and finance and societies and companies owned by Indian residents will also be allowed to set up small finance banks.

Large state-run institutions and big businesses have been barred from setting up small finance banks to ensure that these specialise in lending to small businesses and the poor.

Payments banks can offer payments and remittance services and distribute products such as mutual funds and insurance. They can also issue ATM and debit cards, but not credit cards.

In August 2015, the RBI gave 'in principle' approval to eleven entities to set up Payment Banks which include telecom players Airtel and Vodafone, Reliance Industries, India Post, Aditya Birla Nuvo, Tech Mahindra, among others.

In September 2015, the RBI gave 'in principle' approval to 10 entities to set up small banks. Eight of these are engaged in microfinance. Small banks will be under FDI norms applicable to private banks. They will follow all prudential norms and at least 50 per cent of loan portfolio must be given for advances up to Rs.25 lakhs.

Pradhan Mantri Jan Dhan Yojana (Prime Minister's People Funding Scheme) is an ambitious scheme for comprehensive financial inclusion launched by the Prime Minister on 28th August 2014. The scheme was announced on 15th August 2014. The scheme is run by Department of Financial Services, Ministry of Finance.

Salient features of the scheme are as follows: -

(i) Account holders will be provided zero-balance bank account with RuPay debit card, in addition to accidental, insurance cover of Rs. 1 lakh.

(ii) Those who open accounts by January 20, 2015 over and above the 1 lakh Rs. Accident cover they will be given life insurance cover of Rs. 30,000/-.

(iii) After six months of opening of the bank account, holders can avail Rs. 5,000 loan from the bank.

(iv) With the introduction of new technology introduced by National Payments Corporation of India (NPCI), a person can transfer funds, check balance through a normal phone which was earlier limited only to smart phones so far.

(v) Mobile banking for the poor will be available through National Unified USSD Platform (NUUP) for which banks and mobile companies have come together.

Non-Banking Financial Companies

Non-Banking Financial Companies (NBFCs) broadly fall into three categories, viz.,

(i) NBFCs accepting deposits from the public;

(ii) NBFCs not accepting/holding public deposits: and

(iii) core investment companies (i.e., those acquiring shares / securities of their group/ holding/ subsidiary companies to the extent of not less than 90 percent of total assets and which do not accept public deposit).

NBFCs are a hybrid mix of companies, comprising those which may be engaged in housing finance; those providing various insurance products; those engaged in leasing and hire-purchase business; those providing venture/start-up capital; those engaged in chit fund business; those which may be providing loans against gold and those which may be providing finance for tractors/trucks etc.

An NBFC is a company registered under the Companies Act, 1956. These companies may be primarily those which do not accept deposits from the public.

Moreover, deposit taking NBFCs are those which accept deposits under any scheme or arrangement or another manner but not the way a bank accepts deposits (i.e. these would not be chequeable deposits) and they may also give loans in any manner/arrangement but not the way a bank does.

All deposit-taking NBFCs are called residuary non-banking companies i.e. RNBCs which are regulated by the RBI under RBI Act, 1934 and have to be registered with the RBI.

To prevent dual regulation, certain categories of NBFCs are exempted from the requirement of registration with the RBI as these NBFCs are regulated by other regulators, for example, housing finance companies by NHB; Insurance product companies by IRDA; Venture Capital companies by SEBI and Chit fund companies under the Chit Funds Act, 1982.

Until some years back, the prudential norms applicable to banking and non-banking financial companies were not uniform. Moreover, within the NBFC group, the prudential norms applicable to deposit taking NBFCs (NBFCs-D) were more stringent than those for non-deposit taking NBFCs (NBFCs-ND). Since the NBFCs-ND were not subjected to any exposure norms, they could take large exposures. The absence of capital adequacy requirements resulted in high leverage by the NBFCs. Therefore, since 2000, the Reserve Bank has initiated measures to reduce the scope of "regulatory arbitrage" between banks, NBFCs-D and NBFCs- ND.

Borrowings by NBFCs are mainly from banks and financial institutions and by way of bonds and debentures and "other sources" (which include miscellaneous sources

including money borrowed from other companies, unsecured loans from directors/promoters, commercial paper, borrowings from mutual funds and any other type of funds which are not treated as public deposits). Financial performance of NBFCs improved during 2009-10 due to increases in fund-based and fee-based incomes. Continuing the trend witnessed during the last few years, gross Non Performing Assets (NPAs) as well as net NPAs (as percentage of gross advances and net advances, respectively) of reporting NBFCs declined further during the year ended March 2010.

Every deposit taking NBFC is required to maintain a minimum capital, consisting of Tier-I and Tier-II capital, of not less than 12 percent (15 percent in the case of unrated deposit-taking loan/investment companies) of its aggregate risk-weighted assets and of risk-adjusted value of off-balance sheet items.

With a view to protecting the interests of depositors, regulatory attention was mostly focused on NBFCs accepting public deposits (NBFCs-D) until recently. Over the last few years, however, this regulatory framework has undergone a significant change, with increasingly more attention now being paid to non-deposit taking NBFCs (NBFCs-ND) as well. This change was necessitated mainly on account of a significant increase in both the number and balance sheet size of NBFCs-ND segment which gave rise to systemic concerns. To address this issue, NBFCs-ND with asset size of Rs. 100 crore and above were classified as systemically important NBFCs (NBFCs-ND-SI) and were subjected to "limited regulations". The NBFCs-NDSI are now subject to CRAR and exposure norms prescribed by the Reserve Bank.

The regulatory and supervisory framework of NBFCs continued to focus on prudential regulations with specific attention to the systematically important non-deposit taking companies called NBFC-ND-SI. The RBI released new and stricter norms for NBFCs in November 2014 which, inter-alia, bring them at par with banks as they have to adopt 90 day NPA recognition norm. It has also released requirements for capital adequacy, enhanced disclosure requirements and tighter corporate governance norms.

Proposal to set up "Bad Bank"

The Finance Ministry is considering setting up of a "bad bank" – one that will absorb non-performing assets (NPAs) of public sector lenders. The first bank to use a bad bank strategy was Mellon Bank in the US, which was created in 1988 to hold US $ 1.4 billion of bad loans. It was dissolved in 1995 after repaying bondholders.

The NPA level, currently over 6% of banks' total advances, has become a cause for concern. Once NPAs – loans that do not yield returns – are segregated and transferred into a new "bank", lenders can resume normal business functioning and start lending again instead of focusing on management of bad assets.

The "bad bank" can either hold the bad assets until borrowers start repaying or look at selling those stressed assets to investors. In the US, Citigroup aggregated over US $ 700 billion worth of bad assets into "bad bank" Citi Holdings in 2009. Countries including the UK, Sweden, Finland and Ireland, have "bad banks" as well.

At present, most banks are mainly focused on recovering bad loans. State-owned banks have started loan portfolios as small as Rs. 10 lakh. Credit disbursement has also gone down.

CHAPTER – 8

FISCAL FRAMEWORK AND GOVERNMENT BUDGETING

Public Finance is a study of revenue and expenditure profile of the government. It is also known as government budgeting or fiscal policy of the Government. Fiscal Policy, also called Budgetary policy, comprises of government's revenue, expenditure and borrowing policy which is prepared on an annual basis through the Union Budget.

Major objectives of fiscal policy are broadly as follows:-

(i) To promote and to accelerate the growth of productive investments in the economy.

(ii) To mobilise the maximum volume of real and financial resources for the investment plan of the public sector, keeping in view the expanding demand for real and financial resources of the private sector, and in this way, to promote the growth of marginal and average rate of savings in the economy.

(iii) To promote the maintenance of a reasonable measure of economic stability in keeping with the optimum rate of growth of the economy. This implies maintaining price stability also.

(iv) To redistribute the growing national output to lessen income inequalities by providing subsidies to the poor and imposing higher taxes on the rich as well as on luxuries.

Fiscal policy and monetary policy comprise the two strongest pillars of a country's economic policy.

The Annual Budget of the Central Government (as also the budgets of the State Governments) is a Comprehensive Statement of projections concerning the sources and uses of Government's total receipts for the forthcoming financial year (April-March). The Budget of the Central Government is divided into two parts: revenue budget and capital budget. Revenue budget covers those items which are of a recurring nature. Capital budget covers those items which are concerned with acquiring and disposal of capital assets. Each account has, of course, a receipts and an expenditure side. Revenue receipts, comprising those items that have no repayment liability, are divided into two

groups - tax revenue and non-tax revenue. Tax revenue consists of receipts from a variety of direct and indirect taxes, while non-tax revenue consists of items such as government's interest income from the loans made to States and Union Territories.

Departmental Undertakings such as Railways, Post and Telegraphs and others, dividend income from its ownership of public enterprises; fees and user charges for public services and a few other minor items. Receipts in the capital budget or the capital receipts consist largely, though not entirely, of internal borrowings comprising market loans i.e. loans raised against the issue of Government securities excluding treasury bills, small savings such as post office savings and other small savings instruments, public and State provident funds, railway reserve funds etc. (net of repayment and external borrowings from foreign governments and international financial institutions). They also include recovery of loans and advances and some other receipts on capital account, such as by sale of assets, divestment of shares of public enterprises. Thus, capital receipts by and large consist of receipts which have repayment liabilities. On the expenditure side, the current expenditure (i.e. expenditure on revenue account) is divided into two categories: development expenditure and non-development expenditure. Development expenditure is the expenditure incurred in order to provide those economic and social services which the country requires to maintain and enhance social productivity. It comprises expenditure on social and community services such as education and health and on economic services such as irrigation, research and development, agricultural programmes, export promotion, services to industry, transport and communications etc. On the other hand, non-development expenditure on the current account is a sort of necessary evil (as albeit it must be incurred), as it does little or nothing by way of helping to increase production directly. Among the items included in non-development expenditure are law and order and defence expenditures, general administrative expenditure, subsidies, interest on national debt, welfare payments and pensions. Thus, broadly speaking, revenue expenditure is expenditure on maintenance of existing level of services. On the other hand, capital expenditure is expenditure incurred for acquiring capital assets and infrastructural development which helps in further production. Expenditure on capital account is predominantly development expenditure designed to increase the stock of machinery, equipment and infrastructure but it also includes non-development expenditure which consists of investment in defence and weapons, investments designed to enhance the efficiency of administration etc, and retirement of existing government debt.

CONCEPT OF DEFICITS

A budget can be a balanced budget, surplus budget or a deficit budget. The Union Budget every year projects four deficits viz., revenue deficit, fiscal deficit, primary deficit and effective revenue deficit. It may also project monetised deficit which reflects borrowing from the RBI.

Various deficits that appear in Union Budget are defined as follows:

Revenue Deficit - Revenue Expenditure - Revenue Receipts

This deficit implies what the government spends on a day to day basis (i.e. on revenue account) and what the government earns on a day-to-day basis. The day-to-day expenditure of the government on revenue account invariably has been in excess of its day-to-day receipts causing a serious problem of high revenue deficit year after year. This deficit is in effect deficit on account of fast rising non-plan and consumption expenditure of the government for which government resorts to market borrowing which results in high fiscal deficit. The key to reduce fiscal deficit is to reduce revenue deficit first.

Effective Revenue Deficit: This concept was introduced in the Union Budget 2012-13. Effective Revenue Deficit = Revenue Deficit - Grants given to States for creation of capital assets. These grants are shown in the revenue expenditure of the government.

Fiscal Deficit = Total Expenditure - Revenue Receipts + non-financial liability or non-debt imposing capital receipts (grants, recoveries of past loans, proceeds of sales of assets, divestment proceeds)

The most worrisome aspect of the Centre's fiscal deficit is that nearly three fourth of the borrowings are used for financing unproductive revenue expenditure. This adds to the already high interest burden of the government and threatens a situation of debt trap.

Primary Deficit = Fiscal Deficit- Interest Payments

Primary deficit shows what government's fiscal deficit would have been if there was no burden of interest payments on past loans. A low primary deficit means that most of the fiscal deficit is on account of interest payments. If this deficit is negative, it means that the entire fiscal deficit is on account of interest payments on past loans.

Monetised Deficit = Net increase in the RBI credit to the government which is financed by printing fresh currency. This implies deficit which may be plugged by borrowing from

the RBI and not from banks. In this case, RBI prints fresh currency to finance borrowings of the government.

There are three ways in which a high fiscal deficit can be plugged and financed viz, borrowing from RBI, borrowing from Commercial Banks and borrowing from external sources. Each of these three modes of financing has its own problems for the economy. For example, if the deficit is financed from the RBI, it may lead to excess money supply in the economy which is a potential source of inflation. If it is plugged through external borrowing, it not only raises external debt but also affects credit rating of the government. Borrowing from commercial banks raises internal debt and interest burden.

For medium-term management of the fiscal deficit, and to provide the support of a strong institutional mechanism, the Fiscal Responsibility and Budget Management Act (FRBMA) was enacted in 2003. The Act and the rules laid down under the Act were notified to come into effect from 2004. FRBMA is an important institutional expression to ensure fiscal prudence and support for macro-economic balance. With the enactment of the FRBMA, the traditional annual budgeting moved to a more meaningful medium-term fiscal planning framework. The rules laid down under the Act were as follows:

1. Reduction of revenue deficit by an amount equivalent of 0.5 percent or more of the GDP at the end of each financial year, beginning with 2004-2005.
2. Reduction of fiscal deficit by an amount equivalent of 0.3 percent or more of the GDP at the end of each financial year, beginning with 2004-2005.
3. No assumption of additional liabilities (including external debt at current exchange rate) in excess of 9 percent of GDP for the financial year 2004- 2005 and progressive reduction of this limit by at least one percentage point of GDP in each subsequent year.
4. No guarantees in excess of 0.5 percent of GDP in any financial year, beginning with 2004-2005.
5. Specifies four fiscal indicators to be projected in the medium term fiscal policy statement, which are,

- revenue deficit as a percentage of GDP
- fiscal deficit as a percentage of GDP
- tax revenue as a percentage of GDP, and

- total outstanding liabilities as a percentage of GDP.

6. For greater transparency in the budgetary process, rules mandate the Central Government to disclose changes, if any, in accounting standards, policies and practices that have a bearing on the fiscal indicator. The Government is also mandated to submit statements of receivables and guarantees and "a statement of assets, at the time of presenting the annual financial statement.
7. The rules prescribe the form for the quarterly review of the trends of receipts and expenditures. The rules mandate the Central Government to take appropriate corrective action in case of revenue and fiscal deficits exceeding 45 percent of the budget estimates, or total non-debt receipts falling short of 40 percent of the budget estimates at the end of first half of the financial year.

The FRBM Act was amended in 2012-13.

The amended Act contains two important features of expenditure reforms. First is the introduction of the concept of Effective Revenue Deficit, which excludes from the conventional revenue deficit, grants for the creation of capital assets. With the amendment, the endeavour of the government under the FRBM Act would be to eliminate the Effective Revenue Deficit.

The second important feature is the introduction of the provision for 'Medium Term Expenditure Framework Statement' in the FRBM Act. This medium-term framework provides for three-year rolling targets for expenditure, imparting greater certainty, and encourages prioritization of expenditure. Together with the measures proposed to raise the tax-GDP ratio, the expenditure reforms are expected to yield better fiscal marksmanship, thereby mitigating key fiscal risks. The amended Act also shifts achievement of the targets of revenue deficit and fiscal deficit of zero and 3 percent respectively to 2016-17.

FISCAL MARKSMANSHIP: This implies the degree of precision or accuracy of targets, estimates and forecasts laid down in respect of fiscal parameters like revenue deficit, fiscal deficit, government borrowing, tax-GDP ratio etc. in the budget and other fiscal documents released by the government from time to time. Government's fiscal policy is evaluated not only on overall fiscal marksmanship in terms of fiscal and revenue deficits which are in effect derived indicators, but also on marksmanship in terms of key revenue and expenditure targets.

Fiscal consolidation is necessary for restoring fiscal health of the economy. Fiscal consolidation includes measures aimed at boosting tax and non-tax revenues, reducing unproductive government expenditure and streamlining administrative machinery. These are achieved through tax reforms, broadening the tax base, disinvestment of PSUs, Ways and Means, Advances, reducing and better targeting of subsidies outcome and performance budgeting, reducing interest burden on government borrowing, reducing non-plan expenditure, etc.

TAX STRUCTURE

Any country's tax structure has three kinds of classifications of taxes as follows:-

(i) Direct and Indirect tax

(ii) Progressive and Regressive tax

(iii) Ad valorem and specific tax

A direct tax is a tax whose burden is borne by the same person/entity on whom it is imposed i.e. its burden cannot be shifted. Taxes on income and wealth are direct taxes. By definition, direct taxes reduce inequalities. On the other hand, an indirect tax is imposed on someone but whose burden falls on someone else i.e. its burden can be shifted. Taxes on goods and services are indirect taxes. A progressive tax means a person pays higher tax as his income progresses i.e. the rate of tax on his income goes up as his income rises while a regressive tax means rate of tax comes down as income goes up. An ad valorem tax means tax imposed on the total value of a commodity produced/sold while a specific tax means tax imposed on the basis of specific feature of a commodity viz. length, width, weight, volume etc.

India's Tax Structure

The salient features of India's tax structure are as follows:-

(i) Progressive, which means that as income goes up, the rate of tax goes up so that the rich are taxed at a higher rate than the poor so as to reduce inequalities.

(ii) Prone to evasion which implies that there are too many loopholes and exemptions / rebates which leave enough scope for evasion and avoidance of taxes.

(iii) Complex structure implying that not only tax rates may be high but also with

many slabs giving room for evasion.

(iv) Excludes tax on Agriculture.

Tax reforms introduced in the last two decades have induced structural shift in the composition of tax revenue, marked by a progressive increase in the share of direct taxes in total taxation revenue and a corresponding decline in the share of indirect taxes. The share of direct taxes in the gross tax revenue has progressively increased from 19.1 percent in 1990-91 to 55 percent in 2014-15. India's tax-GDP ratio in 2014-15 was 10.6 per cent.

India's complex tax system suffers from problems in both structures and administration. The tax regime is used for industrial policy where the state gives exemptions and rebates to certain economic activity. Uneven and high tax rates and uneven tax treatment of similar economic activities have induced distortions in the behaviour of firms and households. In addition, the manner of functioning of tax administration is imposing legal risk and substantial compliance costs upon households and firms.

Tax reform in India can improve the ease of doing business and promote efficiency and productivity growth. The tax/GDP ratio of the government must be obtained through a burden –sharing mechanism where low rates apply on a broad set of population, through effective enforcement mechanisms. Taxes clarified as 'bad' in public finance theory like cesses, surcharges, the dividend distribution tax, need to eventually go. Reducing tax-related distortions can increase efficiency and fuel GDP growth. There is consensus that the GST will be a major milestone for indirect tax reform in India. Replacing all existing indirect taxes by the GST will create a national market, eliminate cascading taxes, and align taxation of imports and exports correctly.

Tax administration

The Doing Business Report 2014 ranks India at 158 out of 189 countries under the head 'paying taxes'. Expert Committees have identified problems with the taxation system, including retrospective amendment of laws, frequent amendments, especially after the executive is unable to establish a tax claim in courts, and issues with arbitrary tax claims, especially in transfer pricing. This is coupled with long pendency of disputes and a taxation regime that is unfriendly to foreign investors.

The Central Government levies five major taxes viz. personal income tax, corporate tax, custom duties, union excise duties and service tax, while the principal tax revenue sources of the State Governments are the share of the States in total tax revenue collected by the Centre, commercial taxes like sales tax, turnover tax (now called State Level VAT), land revenue, stamp duty and State excise duties on alcohol and other narcotics, etc. The present position of five main taxes imposed by the Centre is as follows:-

1. Central Excise Duties

These duties are levied by the Centre on commodities which are produced within the country. These duties account for nearly 15.0 percent of gross tax revenue. Major items on which central excise duties are imposed include sugar, cotton, mill cloth, tobacco, motor spirit, matches, cement etc. Commodities on which the State Governments impose excise duties (like liquor and drugs) are exempted from central excise duties.

In recent years, central excise duties have been lowered/exempted on a number of items pertaining to agricultural implements, tractors, health care, hand tools, meat and poultry products, processed food etc. On the other hand, excise duties have been raised on items like contact lenses, playing cards, vacuum flasks, scented supari, imitation jewellery, etc. The Excise Duty regime, popularly known as CENVAT, has been rationalised from time to time with sectoral and structural changes taking place in the economy and in accordance with general lowering of custom duties after the setting up of the WTO.

2. Customs duties

These comprise of duties levied on imports and exports. These duties account for nearly 15.2 percent of gross tax revenue. As export duties reduce the competitive strength of Indian goods in international markets, the government abolished export duties. However, in recent years, it has imposed export duties in order to conserve mineral resources. Import duties perform the following three major functions:

(i) Raise revenue needed by the Government.

(ii) Regulate foreign trade of the country, particularly the imports.

(iii) Offer protection to local industries by imposing tariffs.

As part of structural reforms, the Government has been reforming the structure of customs duties with a view to reduce the role of quantitative restrictions on imports and place increasing reliance on tariffs to regulate imports and reduce rates to ASEAN levels. In order to induce competition and efficiency in the framework of a liberalising economy and to maximise the positive effects of foreign direct investments, the tariffs themselves have been reduced, and peak customs duty has been brought down to 10 percent on non-agricultural goods. The rationale is that if protection levels are high and if there are trade restrictions, foreign investments may become a means of taking advantage of such high tariffs to generate high domestic profits and it may worsen the balance of payments, if it results in large imports of components, raw materials and capital equipment from parent company without adequate exports. Although the reduction of custom tariff rates has unfavourably affected the proportion of customs revenue to gross tax revenue, it has imparted underlying strength to the economy by imparting competition and inducing cost-reducing measures.

3. Corporate Tax

This is levied on the incomes of registered companies and corporations. The rationale for the corporate tax is that a joint stock company has a separate entity, and thus a separate tax different from personal income tax has to be levied on its income. From the Government's point of view, corporate tax is necessary as excess profits can be taxed and even foreign firms operating in India can be taxed. Corporate tax, if directed, can help in promoting investments and thus forcing the corporations to reinvest their profits, and if removed, can provide a windfall gain to corporate groups. Moreover, corporate taxes are progressive and cannot be evaded easily. Corporate tax rate on domestic companies is 30 percent. The Union Budget 2015-16 has to bring it down to 25 per cent in the next four years. There is also a surcharge of 10 per cent on domestic companies whose taxable income exceeds Rs. 10 crores. Corporate tax rate on foreign companies is 40 percent. In addition there is a surcharge of 5 percent for those companies whose taxable income exceeds Rs. 10 crores. Corporate tax accounts for nearly 35.0 percent of gross tax revenue.

4. Personal Income tax

This is levied on the incomes of individuals, Hindu Undivided Families (HUFs), unregistered firms and other associations of people. Taxation is progressive (i.e. with increase in income, tax liability not only increases in absolute terms, but also as a

proportion of income), and, for taxation purposes, income from all sources is added. The Personal Income Tax accounts for nearly 21 per cent of Gross Tax Revenue. The personal Income tax rates are respectively 10, 20 and 30 per cent on slabs of 2.5-5.0 lakhs, 5-10 lakh and 10 lakhs and above.

A surcharge of 12 percent is also levied on taxable incomes above Rs. 1 crore.

5. Service Tax

The indirect tax structure has been broadened in recent years largely by extending the tax net to the fastest growing services sector which accounts for over 55 percent of the GDP. All services except those in the negative list are covered now under the service tax net. This tax is a central levy and the fastest growing tax and accounts for nearly 14.0 percent of gross tax revenue. The Centre has decided to share its proceeds with States for certain services. The rate of service tax at present is 14 percent.

India's tax structure is characterized by the absence of a tax on income from agriculture, which accounts for less than 20 percent of India's GDP. Besides, India's tax structure is such that it encourages evasion due to a large number of rebates and exemptions, thus making it a complex structure. Some of the other features of the tax structure viz., narrow tax base and pre-dominance of indirect taxes have been largely addressed by way of tax reforms carried out since 1991 on the recommendations of Chelliah Committee and subsequently on recommendations of the Kelkar task force.

The government has been implementing these reforms in phases. The focus of Direct Tax reforms has been on lowering of tax-rates, removing/reducing exemptions and rebates, simplification of tax structure, widening the tax base and providing stability in basic tax rates, while the thrust of Indirect Tax reforms has been rationalisation of excise/custom duties, simplification, broadening of indirect tax base (by introducing service tax and VAT), aligning the tax structure to global requirements and preventing/minimising evasion.

PRESUMPTIVE TAXATION

An important aspect of reforms of direct taxation since 1991 has been the concept of Presumptive taxation which has been introduced to broaden the direct tax base. A presumptive tax is a tax imposed/sought to be imposed on the presumption that an individual/company earns enough to pay tax and yet the tax is evaded / avoided. The following presumptive taxes have been introduced:

(i) **Minimum Alternate Tax (MAT)** which is applicable on companies whose book profits are high enough to qualify for tax and yet they use several rebates/deductions under the Income Tax Act to avoid paying tax and thus end up as zero tax companies. In such cases MAT is imposed. The rate of MAT at present is 18.5 percent which implies that if tax on a company's profits is less than 18.5 per cent of its book profits, then book profits shall be taken as the basis of taxation and 18.5 per cent of book profits shall be subjected to tax.

(ii) **Tonnage Tax** under which the notional income arising from the operation of a ship is determined on the basis of the tonnage carried by the ship. The notional income is taxed at the normal corporate tax rate applicable for the year. Tax is payable even if there is a loss in a year. Imposition of Tonnage tax on Indian shipping companies meets their longstanding demand for such a regime, as similar practice exists in most nations. This is expected to attract FDI in the industry as well as make Indian Shipping industry more competitive, as the effective tax rate is likely to come down substantially.

(iii) **Securities Transaction Tax (STT):** This tax, also called turnover tax, was introduced in 2004 on the total value of delivery based equity transactions in the stock market. This means that for every transaction involving sale/purchase of shares, say, worth Rs. 1,000, the buyer and seller will have to share tax equally. STT is applicable at different rates depending upon the security (whether equity or derivative) and the transaction (whether purchase or sell). Service Tax, Surcharge and Education Cess are not applicable on STT.

Value Added Tax (VAT)

Introduction of State Level VAT is the most significant tax reform at State level. The state level VAT replaced the existing state Sales Tax regime w.e.f. April 2005. Since Sales Tax is a State subject, the Central Government has played the role of a facilitator to help States adopt VAT. Technical and financial support has also been provided to the States for VAT computerisation, publicity and awareness and other related aspects.

The Empowered Committee, through its deliberations over the years, finalised a design of VAT to be adopted by the States, which seeks to retain the essential features

of VAT, while at the same time, providing a measure of flexibility to the States, to enable them to meet their local requirements.

In general all the goods including declared goods will be covered under VAT and will get the benefit of input tax credit. Goods which lie outside VAT are liquor, lottery tickets, petrol, diesel, aviation turbine fuel and other motor spirit since their prices are not fully market determined. These will continue to be taxed under the Sales Tax Act or any other State Act or even by making special provisions in the VAT Act itself, and with uniform floor rates decided by the Empowered Committee. Implementation of VAT has led to an increase in States' tax revenues in the last few years.

Central Sales Tax

Central Sales Tax is levied by the Centre on Inter State sale of goods @ 2 percent. Central Government in consultation with the Empowered Committee of State Finance Ministers chalked out the roadmap for phasing out Central Sales Tax (CST) to coincide with the introduction of the proposed GST including the critical component of compensating the States for resultant revenue losses. The scheme finalised in consultation with the Empowered Committee of States provides for new revenue generating measures for States as the primary source of compensation. It also provides for meeting 100 percent of the residuary losses to a State, if any, thereafter, through the budgetary resources of the Centre.

All-India Goods & Services Tax

An All-India Goods and Services Tax (GST) was recommended by Kelkar Task Force on Implementation of FRBM Act in 2004. The GST that would subsume all indirect taxes at the centre and state levels into one uniform indirect tax for the entire country and would satisfy the ideal condition of one-country-one-tax. The task force envisaged that such a tax will not only reduce the cascading burden of a large number of indirect taxes on the final consumer but would also benefit the producer by way of cost reduction, increased productivity and increase in overall demand for the goods. As a result, it would lead to an increase in GDP, tax GDP ratio, eliminate revenue deficit to result in a revenue surplus and thus emerge as the most revolutionary reform of indirect tax structure since Independence. Increase in GDP could be anywhere between 0.9 to 1.7 per cent as estimated by the Task Force.

The government took up the task of implementing GST by floating a discussion paper on the subject. Also, an empowered committee of state finance ministers was set up to bring about a consensus between the Centre and states.

The introduction of the GST would be a significant step in the field of indirect tax reforms in India. By subsuming a large number of central and state taxes into a single tax, it would mitigate cascading or double taxation in a major way and pave the way for a common national market. From the consumer's point of view, the biggest advantage would be in terms of a reduction in the overall tax burden on goods, which is currently estimated at 25 per cent to 30 per cent. Introduction of the GST is also expected to make Indian products competitive in domestic and international markets. Studies show that this would instantly spur economic growth. Because of its transparent character, it is expected that the GST would be easier to administer.

The broad features of the proposed GST model are as follows:

(i) GST would be applicable on supply of goods or services as against the present concept of tax on the manufacture or on sale of goods or on provision of services.

(ii) GST would be a destination-based tax as against the present concept of origin-based tax.

(iii) It would be a dual GST with the centre and the states simultaneously levying it on a common base. The GST to be levied by the centre would be called central GST (CGST) and that to be levied by the states would be called state GST (SGST).

(iv) An integrated GST (IGST) would be levied on inter-state supply (including stock transfers) of goods or services. This would be collected by the centre so that the credit chain is not disrupted.

(v) Import of goods or services would be treated as inter-state supplies and would be subject to IGST in addition to the applicable customs duties.

(vi) A non-vatable additional tax, not exceeding 1 per cent on inter-state supply of goods would be levied by the centre and retained by the originating state at least for a period of two years.

(vii) CGST, SGST and IGST would be levied at rates to be recommended by the Goods and Services Tax Council (GSTC) which will be chaired by the Union Finance Minister and will have Finance Ministers of States as its members.

(viii) GST would apply to all goods and services except alcohol for human consumption.

(ix) GST on petroleum products would be applicable from a date to be recommended by the GST Council.

(x) Tobacco and tobacco products would be subject to the GST. In addition, the centre could continue to levy central excise duty.

(xi) A common threshold exemption would apply to both CGST and SGST. Taxpayers with a turnover below it would be exempt from GST. A compounding option (i.e. to pay tax at a flat rate on turnover without credits) would be available to small taxpayers below a certain threshold. However, a taxable person falling within the limit of threshold or compounding could opt to pay tax at the normal rate in order to be part of the input tax credit chain.

(xii) The list of exempted goods and services would be kept to a minimum and it would be harmonized for the centre and states as far as possible.

(xiii) Exports would be zero-rated.

(xiv) Credit to CGST paid on inputs may be used only for paying CGST on the output and the credit of SGST paid on inputs may be used only for paying SGST. In other words, the two streams of input tax credit (ITC) cannot be cross utilized, except in specified circumstances of inter-state supplies, for payment of IGST.

Federal countries like Canada, New Zealand, and Australia have successfully adopted the GST into their structure. Implementation of a comprehensive GST in India is expected, ceteris paribus, to lead to efficient allocation of factors of production thus bringing about gains in GDP and exports. This would translate into enhanced economic welfare and higher returns to the factors of production, viz., land, labour, and capital. However, in the near-term, as GST replaces a number of state-level and central taxes, revenue gains may not be significant.

The flawless GST not only subsumes all indirect taxes but also all different stages of production and distribution can be interpreted as a mere tax pass-through so that the tax essentially sticks on final consumption within the taxing jurisdiction.

Under GST, both the centre and states will have concurrent powers to tax all goods and services. Therefore, the taxing powers of states would also extend to services which comprise nearly 60 percent of the GDP. Similarly, taxing powers of the centre will extend to the retail stage which comprises 15 percent of GDP.

Since expansion in the power of the states is significantly larger than the centre, the proposed GST will alter the balance of power in favour of states thereby redoing the vertical imbalance.

Most importantly, the GST would be in the nature of VAT with input tax credit available on inputs as well as previous purchases, at each stage up to the final consumer. As such, GST would be in the nature of VAT on final consumption so that the burden of GST would fall on the final consumer. It would, therefore, be a tax on final consumption called consumption based tax. Since India is a federal state, the GST will be in the nature of a dual GST and, according to the proposed structure, revenue from GST will be shared between the centre and states. In other words, GST will have to components viz, CGST and SGST which would be levied by the centre and state respectively on all transactions of goods and services i.e. CGST and SGST would be applicable on same transaction at the final consumer point. As a result, tax base will shift from production to consumption.

Basic difference between tax burden under present indirect tax regime and GST can be explained with the help of following table: -

Particulars	Present regime (Rs.)	GST (Rs.)
Value of goods	2000	
Excise Duty @12%	240	
VAT@12.5%	281	
CGST@5%		100
SGST@7%		140
Total tax	**521**	**240**

Thus under GST a purchaser pays much lower tax than under present regime.

Merits of GST

1. It will reduce the cascading burden of a large number of indirect taxes at the centre and state levels.
2. It is expected to moderate prices and boost demand and consumption.
3. It will bring uniformity by way of one country one tax.

4. It will rationalise and simplify indirect tax structure.
5. It is expected to increase GDP, TAX GDP ratio and bring a revenue surplus and thus reduce fiscal deficit.
6. It will integrate Indian economy with the rest of the world as most countries have GST in place.
7. It will build India as a common market.
8. It will raise productivity, reduce distortions and increase the rate of GDP growth.

GST is expected to be extremely beneficial for manufacturing sector as it will help reduce delays due to octroi, resulting in quicker movement of goods and reduction in costs.

There are however, many issues relating to GST which need to be resolved before it is implemented. These are as follows:

1. Its proposed structure is flawed by international standards because it excludes petroleum and alcohol products which account for 40-50 percent of revenue from indirect taxes. Excluding them means no information on them, while in the rest of the world they are included in GST and at best they use additional selective excises on them to gather more revenue.
2. Goods and services should not be listed separately as it defeats the whole purpose of creating a seamless treatment between them. The legal complexity of defining them should go away.
3. A well developed system of clearing house is required for inter-state trade for which India's IT system is not ready. This can create insurmountable problems of high GST evasion as it happened in 1986 with the introduction of MODVAT. It took years for the European Union to implement GST which could be foolproof. Likewise, New Zealand and Canada have managed the transition to GST largely through strong political leadership as well as meticulous planning & implementation.
4. The proposed rate of 16 percent may be high as compared to the present VAT rates of 12.5 percent, CENVAT 10 percent and service tax 10 percent. This rate of 16 percent may be unsustainable and could defeat the purpose

of GST. The 13th Finance Commission has proposed a 12 percent GST rate which appears more rational.

5. States have expressed their discontent as they would get 8 percent out of 16 percent while at present they get 12.5 percent by way of state VAT.
6. Implementation of GST is pre-conditioned by two major constitutional amendments - one to permit the centre to tax sales and the other to permit states to tax services. These may not come easily.
7. Its successful implementation requires a strong technological back bone to track transactions at each stage, otherwise there are fears of loss of revenue to states. The centre has entrusted this task to a panel headed by Nandan Nilekani.
8. The issue of compensation to be given to states in the event of loss of revenue for which the centre has, committed to compensate states.
9. Basic import duties have been kept out of GST, which is in contrast to what Kelkar Task Force recommended. The empowered committee has been having a constant dialogue with states to iron out difference and strike a consensus. Many states, particularly those not under the ruling party regime have expressed serious reservations on GST.
10. States' apprehend loss of autonomy under GST both in respect of rate determination as well as dispute settlement.

A study on GST also points out problems like (a) merging existing laws on excise duty, VAT and Service Tax together; (b) uncertainty about final GST rate or rates with States insisting on 26 per cent and the Centre on 16-18 per cent (a GST levy of even 16 per cent is likely to result in large scale evasion at the retail level); (c) Concept of dual GST is complex as most countries (except Canada and Brazil) have single GST; (d) ~~GST may result in unequal states treated equally; (e) GST will make imports competitive~~ as GST on imports will be available as a credit to a trader, so that imported goods will get a competitive advantage, seriously sabotaging the Make in India initiative.

Meanwhile, a Constitution Amendment Bill for the Goods and Services Tax that largely accommodates the demands made by states has been passed. Main proposals of the Bill are as follows:

(1) It proposes to give states a five-year compensation time-line for revenue losses – 100 percent for the first three years, 75 percent for the fourth year and 50 percent for the fifth year.

(2) Central and state GST will be decided by the GST Council.

(3) Petroleum products, though part of the Bill, will not be subject to GST until the GST Council decides.

(4) States with manufacturing activity will get additional 1 percent on inter-state trade for two years i.e., on supply of goods in inter-state trade in lieu of entry tax that will be subsumed in GST.

(5) Alcohol shall be kept out of GST at present.

(6) There will be a uniform GST, but a narrow band will be allowed over the floor rate for flexibility.

(7) Centre will also levy and collect integrated GST on inter-state sales which will be distributed among states.

(8) A new article 246A will give simultaneous powers to Union and states to legislate on GST.

(9) A new article 279A will create a GST Council, a joint forum of states and centre which will be headed by Finance Minister.

(10) The GST Council will have state finance ministers as members. States will have 2/3 voting power in GST Council. All decisions will have to be passed by 75 percent vote.

(11) States will levy and collect GST within their respective boundaries.

(12) Both centre and states will simultaneously levy GST.

Direct Taxes Code (DTC)

While GST is viewed as the ultimate reform of indirect tax structure in India, the Direct Taxes Code introduced in 2010 is seen as the ultimate reform of direct tax structure.

The Code seeks to consolidate and amend the laws relating to all direct taxes, so as to establish an economically efficient, effective and equitable direct tax system which will facilitate voluntary compliance and help increase the tax-GDP ratio. All the direct taxes are sought to be brought under a single code and compliance procedures unified, which will eventually pave the way for single unified tax payer reporting system. The need for the Code arose from concerns about the complex structure of the Income Tax

Act, numerous amendments making it incomprehensible to the average tax payer and frequent policy changes due to changing economic environment.

The DTC states that marginal tax rates have been steadily lowered and the rate structure rationalized to reflect best international practices and any further rationalization of the tax rates may not be feasible without corresponding increase in the tax base to enhance revenue productivity of the tax system and improve its horizontal.

A threefold strategy for broadening the base has been articulated in the Code:

(1) The first element of the strategy is to minimize exemptions that have eroded the tax base. The removal of these exemptions would result in a higher tax-GDP ratio; enhance GDP growth; improve equity (both horizontal and vertical); reduce compliance costs; lower administrative burdens; and discourage corruption.

(2) The second element of the strategy seeks to address the problem of ambiguity in the law which facilitates tax avoidance.

(3) The third element of the strategy relates to checking of erosion of the tax base through tax evasion.

Salient Features and Highlights of the DTC are as follows:

1. DTC removes most of the categories of exempted income. Unit Linked Plans (ULIPs), Equity Linked Mutual Funds (ELSS), Term deposits, NSCs (National Savings certificates), Long term infrastructures bonds, house loan principal repayment, stamp duty and registration fees on purchase of house property will lose tax benefits.

2. Tax saving based investment limit remains 1 lakh but another 50,000 has been added for pure life insurance (Sum insured is at least 20 times the premium paid), health insurance, mediclaim policies and tuition fees of children. But the one lakh investment can only be done in provident fund, superannuation fund, gratuity fund and new pension fund.

3. Exemption will remain the same at 1.5 lakh per year for interest on housing loan for self-occupied property.

4. Only half of Short - term capital gains will be taxed, e.g. if one gains 50,000, only 25,000 will be taxed. Long term capital gains (From equities and equity mutual funds, on which STT has been paid) are still exempted from income tax.

5. Tax exemption at all three stages (EEE) - savings, accretions and withdrawals - to be allowed for provident funds (GPF, EPF, and PPF), NPS (new pension scheme administered by PFRDA), Retirement benefits (gratuity, leave encashment ,etc), pure life insurance products & annuity schemes. Earlier DTC wanted to tax withdrawals.

6. Surcharge and education cess are to be abolished.

7. Tax exemption on LTA (Leave travel allowance) is abolished.

8. Tax exemption on Education loan to continue.

9. Corporate tax reduced from 34% to 30% including education cess and surcharge.

10. For taxation of Capital gains from property sale within one year, gain is to be added to taxable salary. For long term gain (after one year of purchase), instead of flat rate of 20% of gain after indexation benefit, new concept has been introduced. Now gain after indexation will be added to taxable income and taxed as per the tax slab. Base date for cost of acquisition has been changed to 1st April, 2000 instead of earlier 1st April, 1981.

11. Maximum limit for medical reimbursements has been increased to Rs. -50,000 per year from current Rs. 15,000 limit.

12. Dividends will attract 5% tax.

13. As per the current laws, a NRI is liable to pay tax on global income if he is in India for a period of more than 182 days in a financial year. But in the new bill, this duration has been changed to just 60 days.

14. It consolidates and integrates all direct tax laws and replaces both the Income Tax Act 1961 and the Wealth Tax Act 1957 with a single legislation.

15. It simplifies the language of the legislation. The use of direct, active speech, expressing only a single point through one sub - section and rearranging the provisions into a rational structure will assist a lay person to understand the provisions of the DTC.

16. It indicates stability in direct tax rates. Currently, the rates of tax for a particular year are stipulated in the Finance Act for that relevant year. Therefore, even if there is no change proposed in the rates of tax, the Finance Bill has still to be passed indicating the same rates of tax. Under the Code, all rates of taxes are

proposed to be prescribed in Schedules to the Code, thereby obviating the need for an annual finance bill, if no change in the tax rate is proposed.

17. It strengthens taxation provisions for international transaction. In the context of a globalized economy, it has become necessary to provide a stable framework for taxation of international transactions and global capital.

18. General Anti Avoidance Rule to curb Aggressive Tax Planning - Direct tax rates have been moderated over the last decade and are in line with international norms. A general anti-avoidance rule assists the tax administration in deterring aggressive tax avoidance in a globalized economy. Such general anti- avoidance rules already form a part of the tax legislation in a number of G- 20 countries. These will also apply to investments under DTAAs.

Some of the important provisions of DTC have since been incorporated in the tax structure. As such, DTC has been abandoned as proposed in the Union Budget of 2015-16.

GENERAL ANTI-AVOIDANCE RULES (GAAR)

GAAR is incorporated in Direct Tax Code as a very important provision of direct tax policy.

Objective of GAAR: Its objective is to prevent misuse and abuse of tax policy and counter aggressive tax avoidance schemes while ensuring that it is used only in appropriate cases by enabling a review of GAAR. It aims at preventing deals and incomes that are structured only to avoid paying tax. The global practice on anti-avoidance rules is that most countries have codified "substance over form" doctrine in the form of GAAR. As many as 30 countries have such rules, including many of the G-20 countries. There are also retrospective tax provisions in these rules in many countries.

GAAR has generated a serious debate in India not only due to its retro tax provisions but also for having created uncertainty in tax policy. These rules along with DTC were referred to a Parliamentary Standing Committee in March, 2012 which observed as follows:

1. GAAR gives arbitrary powers to taxmen to challenge complex deals. Such powers are prone to misuse.
2. Onus lies on the taxpayer to prove that a transaction is genuine.

3. The paper cannot seek an advance ruling on whether a transaction would be covered by GAAR.

4. It has created uncertainty and ambiguity among investors.

The Standing Committee has recommended following amendments:

1. removing discretionary powers of taxmen;
2. evolving proper guidelines;
3. having a threshold above which tax should be imposed; and
4. taxpayer should enjoy the option of advance ruling.

Based on these recommendations, a review of GAAR is being carried out on the following lines:

(a) fixing a monetary threshold;

(b) onus to lie with the tax authorities;

(c) laying down appropriate guidelines;

(d) orders of the Commissioner involving GAAR should be subject to approval of Dispute Resolution Panel which would be a collegium of three Commissioners of income tax;

(e) provision for advance ruling;

(f) there should be a time limit within which Commissioner will have to decide whether to impose GAAR or not;

(g) an appropriate panel will have to decide on GAAR cases;

(h) retro tax provisions shall apply;

(i) short term capital gains made in investments through shell entities like tax heavens shall be subjected to tax;

(j) investments in the nature of round tripping shall attract GAAR; and

(k) P-Notes shall not be subjected to GAAR.

The Government set up Parathasarthy Shome Committee to review GAAR. The Committee gave its report in September 2012 recommending as follows:

(i) GAAR should be deferred till 2016-17.

(ii) GAAR should not have retrospective effect and should apply only to taxes of more than Rs. 3 crore.

(iii) GAAR should not be imposed for Singapore and Mauritius.

(iv) There should be no short-term Capital gains tax on investments in stock markets including those on FIIs and non-residents.

(v) Government should specify illustrative negative list for tax mitigation,

(vi) GAAR should not be imposed on intra-group transactions.

(vii) Grandfather all existing investments involving a question of taxation of overseas entities.

(viii) Rate of STT should be raised to make up for loss in not imposing Capital gains tax.

Based on these recommendations, GAAR rules have been notified according to which there will be no retro tax and GAAR will be in force from April 2016.

OUTCOME BUDGET

A system of performance budgeting by Ministries handling development programmes was introduced in 1969 following the recommendations of the Administrative Reforms Commission. For long, a need has been felt to address certain weaknesses that have crept into the performance budgeting framework such as lack of clear one-to-one relationship between the financial and the performance budgets and inadequate target-setting in physical terms for the ensuing year. Besides, there is a growing concern to track not just the more readily measurable intermediate physical "outputs" but the "outcomes" which are the end objectives of state intervention. A beginning on 'Outcome Budget' was made in 2005-2006 with a conceptual framework and a broad roadmap of future reforms.

The process, of conversion of outlays into outcomes is a long one with several intermediate stages and complementary resources required in achieving intended impact. The cause and effect chain is not always direct, and several environmental factors influence the actual impact and outcomes.

Outlays are financial resources deployed for achieving certain outcomes. Part of the money may be directly from the budget and part from other stakeholders such as

State Governments, public sector undertakings (PSUs) or even private parties in the growing areas of PPP. Inputs are physical resources subsumed under outlays.

Outputs are a measure of the physical quantity of the goods or services produced through a government scheme or programme. They are usually an intermediate stage between 'outlays' and 'outcomes'. For example, construction of a school building is the 'output', while increase in the literacy rate is the 'final outcome' or impact.

Outcomes or impact are the end results of various Government initiatives and interventions. Going beyond mere 'outputs', they cover the quality and effectiveness of the goods or services produced as a consequence of an intervention. In poverty monitoring, impact is placed at a higher level than outcomes. Overall well-being or living standards of the poor is treated as a higher level impact with outcome defined as Poor's access to and use of goods and services.

Thus, goals, indicators and targets have been drawn up for various schemes and programmes. The Ministries/Departments would engage independent evaluators and assessment agencies for scrutiny/evaluation of the achievements against physical outputs and final outcomes of major flagship schemes. Guidelines for preparation of the outcome budget by various Ministries have been issued.

GENDER BUDGETING

Introduced first of all in Australia in 1984, the concept implies that the budget data should be presented in a manner so that the gender sensitivities of the budgetary allocations are clearly highlighted. Gender budgeting was introduced in India in 2005-2006. The main objective is to main-stream gender perspective in all sectoral policies and programmes and to work towards the ultimate goal of eliminating gender discrimination and creating enabling environment for gender justice and empowerment of women.

REVENUE FOREGONE/TAX EXPENDITURE

Tax Expenditure means the difference between statutory tax rates notified in the schedules of taxation and the Act for effective tax rates (i.e., rates after taking into account various rebates and concessions). Thus, there is enormous loss of revenue due to various concessions and rebates. For example, tax foregone or revenue foregone on account of rebates and concessions was estimated at Rs. 5.73 lakh crores in 2013-14.

The exemptions and incentives in the tax laws, which result in tax expenditures, distort resource allocation by impinging upon the efficiency of the market. Further, they complicate the tax laws, increase litigation and raise the compliance cost for the taxpayers and the tax administration. Tax incentives and exemptions are being continuously reviewed so as to eliminate or provide a sunset clause to those that have outlived their rationale. A tax expenditure statement enables a more informed public debate on the efficacy of exemptions and discourages entrenched groups from demanding incentives in perpetuity. The Government has been estimating tax expenditure by preparing what is called the statement on Revenue forgone.

In its quest for improving the fiscal health of the economy, the government has also prepared a "Statement of Revenue Foregone" (Tax Expenditure Statement) to track the impact of exemptions and rebates on the tax revenues collected by the government. It has been estimated that the revenue foregone is over 50 percent of gross tax collections.

GOVERNMENT EXPENDITURE

Government Expenditure is the other important component of fiscal policy which involves a detailed study. The budgeted expenditure during a year can be split in two parts, viz. (a) plan expenditure, and (b) non-plan expenditure. Plan expenditure consists of budget provisions for those schemes or programmes that have been included in the Five Year Plan. In a Five Year Plan, the financial allocations between different heads are made for a period of five years. Within these broad parameters, annual allocations are made in the budget. Non-Plan expenditure is a generic term. It includes both developmental and on-developmental expenditure. Part of the expenditure is obligatory in nature, e.g. interest payments, pensionary charges and statutory transfers to States. Part of the expenditure is an essential obligation of the State e.g. defence and internal security. More importantly, expenditure on maintaining those assets created in previous plans is also treated as non-plan expenditure. Similarly, expenditure on continuing services and activities at levels already reached in the plan period is shifted to non-plan in the next plan e.g. educational and health facilities, continuing research projects and operating expenses of power stations. Thus, as more plans are completed, a large amount of expenditure on operation and maintenance of facilities and services created gets added to non-plan expenditure besides the interest on government borrowings to

finance the plan. Thus, as our plan size grows, expenditure under the non-plan category grows larger.

Non-Plan expenditure has been the focus of considerable criticism from many quarters. Though much of the criticism is valid mainly on the premise that we have to learn to manage within our plan expenses, a more detailed study of non-plan expenditure shows that many of the constituent items, though not directly productive in the short run, are vital for the long-term developmental and social goals of the economy. For example, expenditure on the maintenance of assets, though not reckoned as plan expenditure, is as crucial to the success of a plan as the expenditure on the plan schemes themselves. Sometimes this is overlooked with the result that while new roads are constructed, new schools opened and new irrigation projects set up out of the plan funds, these roads are not maintained, the schools are neglected, and the irrigation projects are not properly maintained in the absence of maintenance grants for recurring expenditure, thus defeating the very purpose for which the plan expenditure was originally incurred. In recent years, the distinction between plan and non-plan expenditure has become an issue of serious debate and the government has been thinking in terms of doing away with this distinction as there is no such distinction laid down in the Constitution. It is felt that removal of this distinction would provide the much needed flexibility in the use of funds.

Over the years, the growth in non-plan expenditure has been much higher as compared to plan expenditure. But, this growth in non-plan expenditure has been mainly on account of unprecedented increase in such unproductive items of non-plan expenditure as interest payments, subsidies, defence and civil administration.

The composition of central government expenditure has become highly rigid and prone to large, pre-committed increases. Interest payments, defence, internal security, major subsidies, salaries, allowances and pension and non-plan grants to States account for about 95 percent of the non-plan expenditure and about 70 percent of the total expenditure.

Rise in overall expenditure of the government, both plan and non-plan, is no doubt a logical corollary of the rising commitments of a modern welfare State. But the rate at which particularly the non-plan expenditure has been rising and the composition of this expenditure has now started sending alarm signals by way of a high fiscal deficit and rising interest burden of the government.

Rangarajan Panel on Public Expenditure set up in 2010 submitted its report in 2012. Its main recommendations were as follows:

1. Distinction between Plan and Non-Plan expenditure should be abolished as it has become dysfunctional.
2. Budgeting approach should shift from input based budget to output and outcomes.
3. There should be distinction based on revenue and capital expenditure rather than Plan and Non-Plan.

A Committee set up under Bimal Jalan in 2014 to review government policy on expenditure management was since given interim report. The government has decided to abolish the Planning Commission and set up a separate apex body for planning and development. The Rangarajan Committee set up in 2012 had recommended abolition of this distinction and replacing it with distinction between revenue expenditure and capital expenditure.

A new body NITI – National Institution for Transforming India has been set up to replace the Planning Commission. This will function as a think-tank headed by the Prime Minister with a governing council of Chief Ministers and Lt. Governors similar to the NDC. This body will substitute centralised planning with a bottoms-up approach based on cooperative federalism.

Subsidies

Three major subsidies of the Centre are food, fertilisers and petroleum. Food subsidy as a fiscal policy tool seeks to serve two separate and potentially conflicting objectives of protecting producers' interest through payment of 'remunerative' prices and also keeping prices stable/low for consumers. With the inefficiencies and rent seeking associated with the public provision of goods and services, the income transfer to poor consumers through a unit increase in subsidy goes down. A recent study, "Performance Evaluation of the Targeted Public Distribution System" by the Programme Evaluation Organisation, Planning Commission has estimated that to transfer Re. 1 to the poor, Government spends Rs. 3.65 in the form of food subsidy, indicating that cash or near cash transfer could lead to large welfare gains for the poor. With the unprecedented rise in the international prices of petroleum, given the sizeable production through high cost feedstock in urea units, fertiliser subsidy has also risen sharply.

A paper prepared by the National institute of Public Finance and Policy estimates the quantum of total subsidies (unrecovered costs in the provision of non-public goods), and analyses three major explicit subsidies provided by the Government, viz., subsidies on food, fertilisers and petroleum products (LPG for domestic use and kerosene for PDS).

Cash Subsidy Model

The government, has prepared a cash subsidy model under which recipients of subsidised cooking gas, fertiliser and kerosene will get direct cash transfers while state government will work out a policy for providing cash subsidy for kerosene. These are the key recommendations of the task force chaired by UIDAI chairman Nandan Nilekani to suggest ways to plug leakages in the current subsidy framework for kerosene, LPG and fertiliser.

Listing out the benefits of a direct subsidy regime, the task force debates that a direct subsidy transfer framework facilitates monitoring the subsidy transactions carried out at different levels and provides a powerful reconciliation and social audit mechanism.

The task force has charted out a, three-step plan to switch to direct subsidies which can be transferred through banks, ATMs, post offices or mobile banking. An IT platform or Aadhaar or unique identity cards will form the backbone of the direct subsidy regime. It has suggested setting up an IT - driven Core Subsidy Management Platform that would automate all business processes and maintain bookkeeping information on entitlement and subsidies for all beneficiaries.

In the first phase, the task force has suggested taking up the Petroleum Ministry's recommendation to limit the numbers of subsidised LPG cylinders that are given to beneficiaries. In the second phase, it has called for direct cash transfer of subsidies to a beneficiary's bank account, while in the final stage, it has suggested segmentation and targeting of intended beneficiaries.

Similarly, in the case of fertiliser, the panel has recommended improving transparency across the supply chain by providing information on the manufacturer, distributor and retailer. In the second phase, the government can directly transfer cash subsidy to the retailer's bank account, and in the third phase it can transfer it to the farmer's bank account.

The task force feels that the system of subsidies is more complicated in the case of Kerosene due to its distribution channel, and calls for wider consultation with states and reforms in the public distribution system. It has recommended direct transfer of subsidy through State in Phase I and to the beneficiary's account in Phase II. The task force has recommended pilot projects in seven States - Tamil Nadu, Assam, Maharashtra, Haryana, Delhi, Rajasthan and Orissa - that would be carried out over the next six months.

A wholesale transition from the PDS to cash transfers in rural India would be misguided and at the very least premature. For poor people, food entitlements have several advantages over cash transfers. First, they are inflation-proof, unlike cash transfers that can be eroded by local price increases, even if they are indexed to the general price level. Second, food tends to be consumed more wisely and sparingly; cash, on the other hand, can easily be misused. Third, food is shared equitably" within the family, while cash can easily be cornered by selfish individuals. Fourth, the PDS network has a much wider reach than the banking system. In remote areas, where the need for social assistance is the greatest, banking facilities are simply not ready for a system of cash transfers (as it is, they are unable, to cope with NREGAS wage payments). Last but not least, cash transfers are likely to bring in their trail predatory commercial interests and exploitative elements, eager to sell alcohol, branded products, fake insurance policies or other items that would contribute very little to people's nutrition or well-being.

Cash transfers have their advantages too: they have lower transaction costs, are (potentially) more convenient for migrant labourers, and may be easier to monitor. Sometime in the future, when the banking system has a wider reach and the food security problem has been resolved, a cautious transition to cash transfers may be advisable. For Kerosene, cash transfers can bring to an end the Kerosene mafia and cartel. For fertilisers, cash subsidies would mean that only the farmer benefits and not the industry also as at present. Besides, cash can be used by the former to buy best quality fertiliser.

The most common argument for cash transfers is that cash makes it possible to satisfy variety of needs (not just food), and that people are best judges of their own priorities.

Direct Benefit Transfer (DBT)

The DBT plan was introduced on 1 January 2013 with seven schemes in 20 districts. India has embarked on a DBT scheme in selected districts wherein it has been envisaged that benefits such as scholarships, pensions, and MGNREGA (Mahatma Gandhi National Rural Employment Guarantee Act) wages will be directly credited to the bank or post office accounts of identified beneficiaries. The DBT scheme will not substitute entirely for delivery of public services for now. It will replace neither food and kerosene subsidies under the TPDS nor fertilizer subsidies. The DBT is designed to improve targeting, reduce corruption, eliminate waste, control expenditure, and facilitate reforms. Electronic transfer of benefits is a simple design change and transfers that are already taking place through paper and cash mode will now be done through electronic transfers. This has been enabled by rapid roll out of Aadhaar (Unique Identity) along with the National Population Register. The DBT in tandem with such unique identification will ensure that the benefits reach the target groups faster and minimize inclusion and exclusion errors as well as corruption that are associated with manual processes.

14th Finance Commission

The 14th Finance Commission was constituted in January 2013 under the Chairmanship of Dr. Y. V. Reddy, former RBI Governor.

The following are the broad Terms of Reference and the matters to be taken into consideration by the 14th Finance Commission in making the recommendations:-

(i) the distribution between the union and states of the net proceeds of taxes which are to be, or may be, divided between them under Chapter I, Part XII of the Constitution and the allocation between the states of the respective shares of such proceeds;

(ii) the principles which should govern the grants-in-aid of the revenues of the states out of the Consolidated Fund of India and the sums to be paid to the states which are in need of assistance by way of grants-in-aid of their revenues under article 275 of the Constitution for purposes other than those specified in the provisos to clause (1) of that article; and

(iii) measures needed to augment the Consolidated Fund of a state, to supplement the resources of the panchayats and municipalities in the state on the basis of the recommendations made by the Finance Commission of

the state.

The Commission has been mandated to review the state of finances, deficit, and debt levels of the union and states and suggest measures for maintaining a stable and sustainable fiscal environment consistent with equitable growth including suggestions to amend the FRBMAs currently in force. The Commission has been asked to consider and recommend incentives and disincentives for states for observing the obligations laid down in the FRBMAs.

The Commission is required to generally take the base of population figures as of 1971 in all cases where population is a factor for determination of devolution of taxes and duties and grants-in-aid; however, the Commission may also take into account the demographic changes that have taken place subsequent to 1971.

It is to review the present public expenditure management systems in place including budgeting and accounting standards and practices; the existing system of classification of receipts and expenditure; linking outlays to outputs and outcomes; best practices within the country and internationally and to make appropriate recommendations thereon.

It is also to review the present arrangements as regards financing of Disaster Management with reference to the funds constituted under the Disaster Management Act and make appropriate recommendations thereon. It has to indicate the basis on which it has arrived at its findings and make available the state-wise estimates of receipts and expenditure.

The Commission submitted its report to the President on December 16, 2014. One of its major recommendations is to raise the share of states in net proceeds of central taxes from 32 percent to 42 percent. It has also recommended that all non-tax fund transfers to states should be delinked from schemes. In other words, it has argued for simplifying transfer of resources to states and said that tied aid from the Centre reduces the efficacy of the fund transfer.

Important concepts/terminologies related to Fiscal framework are as follows:

(i) **Buoyancy of Tax:** This is defined in terms of percentage change in tax revenue as a result of change in GDP. If one per cent rise in GDP results in more than 1 per cent increase in tax revenue (without any change in tax rates) it can be said that a country's tax structure has greater buoyancy. Buoyancy is different from

elasticity of a tax – the latter relates to percentage increase/decrease in tax revenue as a result of percentage change in tax rates and tax base.

(ii) **TAX BASE** means the quantity or coverage of what is taxed.

(iii) **TAX AVOIDANCE** means arranging one's financial affairs within the law so as to minimise tax liability, as opposed to tax evasion which implies failure to meet actual tax liabilities by not declaring income/profit.

(iv) **TAX INCIDENCE** means the ultimate distribution of the burden of tax i.e. who bears the ultimate burden of a tax.

(v) **FISCAL DRAG** means the effect of inflation upon effective tax rates due to which under progressive taxation; more and more people may come under higher tax brackets without corresponding increase in their real income. As a result, they end up paying higher taxes while the economy may suffer due to declining demand which could drag down the GDP growth rate.

(vi) **LAFFER CURVE** – developed by American Economists Arthur Laffer, this curve establishes relationship between tax rates and tax revenue and argues that there exists an optimum rate of tax at which government revenue is maximised. The argument runs as follows: If tax rates are low, revenues will be increased if tax rates are increased; however, if tax rates are raised beyond the optimum point the loss of incentives caused by the resultant low net incomes discourages production and tax revenues fall.

(vii) **CROWDING OUT** – It is a situation in which, as a result of high fiscal-deficit and consequent excessive borrowing by the government from banks, there is less liquidity left with banks to lend to the private sector so that private sector is crowded out.

(viii) **FISCAL STIMULUS** – implies increased government spending on infrastructure and public works programmes as well as reduction of tax rates – generally indirect tax rates during a period of slowdown and recession so as to revive the economy by raising people's purchasing power. This is called counter-cyclical fiscal policy under which on the one hand, government increases its expenditure which in economic jargon is called Pump Priming and on the other reduces tax rates – both of which put more money in the hands of the people so that demand goes up, investment picks up and the economy travels towards an upward path.

UNION BUDGET 2015-16

Major tax proposals in Union Budget are as follows:

- Abolition of Wealth Tax
- Additional 2% surcharge for the super rich with income of over Rs. 1 crore.
- Rate of corporate tax to be reduced to 25% over next four years.
- No change in tax slabs.
- 100% exemption for contribution to Swachch Bharat, apart from CS.
- Service tax increased to 14 per cent by subsuming education cess.

Fiscal deficit for 2015-16 has been projected at 3.9 per cent of GDP and revenue deficit at 2.8 per cent. A Swachch Bharat Cess of 2 per cent or less is proposed on all or certain services if need arises.

With a view to reduce gold imports and enable productive use of gold, two schemes have been proposed viz., Sovereign Gold Bond Scheme as an alternative to purchasing metal gold and Gold Monetisation Scheme for depositors of gold to earn interest and for jewellers to obtain loans on their metal account.

The Budget also proposed to merge the Forwards Markets Commission (FMC) with the SEBI. The merger has since taken place.

CHAPTER – 9

INFLATION

Inflation is defined as a situation in which there is a gradual rise in the general price level and a fall in the value / purchasing power of money observed over a period of time which may generate expectations of a further rise. Inflation implies a sustained, unchecked rise in the general price level observed over a period of time rather than a one-time rise.

VARIOUS FORMS OF INFLATION

There are various forms of inflation depending upon its severity, causal factors and the kind of sectors it is related to. These are as follows: -

(a) **Galloping Inflation**: Also known as hopping inflation/jumping inflation/ runaway inflation characterized by double or triple digit rise in the general price level which could be as high as 10 to 900 percent.

(b) **Hyper Inflation**: This implies a very rapid rate of increase up to a million percentage annual rise which results in a rapid fall in the purchasing power of money so much that people lose faith in the domestic currency and start opting for physical assets, gold and foreign currency which are inflation proof. This may force the policy makers to use an alternate currency or switch over to barter. The most prominent example of hyperinflation is the post first world war Germany (1920 - 23) when at the end of 1923, prices were nearly 35 billion times higher than 1920.

(c) **Core Inflation:** This is defined on the basis of goods and services which may be excluded while calculating inflation. It is a popular concept used in western ~~economics which exclude energy and food articles while calculating inflation.~~ Thus, core inflation is inflation confined to non-energy and non-food articles. In India, non-food manufacturing inflation is defined as 'core inflation' by the RBI. Within the non-food manufacturing group are commodities like beverages, tobacco products, wood and wood products, chemicals and chemical products, machinery and transport equipment, capital goods and consumer durables. Core inflation is also called Underlying Inflation.

(d) **Stagflation:** This is a typical situation in which inflation coexists with recession and unemployment. It is essentially a combination of high inflation and low growth.

(e) **Deflation:** This implies a sustained and widespread fall in the general price level observed over a period of time. It is just the opposite of inflation.

(f) **Disinflation:** This implies a reduction in the rate of inflation. For example, if the rate of inflation falls from 8 per cent to 6 per cent to 4 per cent, we can call it disinflation.

(g) **Reflation:** is a deliberate policy adopted by the government and monetary authorities to counter deflationary situation. This is done by higher public expenditure, tax cuts, interest rate reduction, etc.

Depending upon causal factors, inflation is categorized into Demand-Pull inflation and Cost-Push inflation. The former set of factors are those due to which there is an overall rise in the demand for goods and services in general. On the other hand, the latter set of factors are those due to which there is either a scarcity or shortfall in the supply of goods and services or/and an increase in the cost of production and distribution of goods and services. A detailed explanation of these factors is given below, particularly how these factors manifest themselves in the Indian economy. In fact, causes of inflation in any economy can be explained only on the basis of Demand-Pull causes and Cost-Push causes.

I. Demand-Pull Factors:

1. **Mounting Government expenditure** - Government expenditure has been rising steadily over the years. It implies a rising demand for goods and services. Moreover, continuous increase in government expenditure has the effect of putting in large money income in the hands of the general public thereby raising their purchase power and stoking the fire of inflation. In India, it is the non-plan expenditure, which is mainly responsible because most of the non-plan expenditure is non-productive and hence only adds to purchasing power and demand without adding to production. Thus, too much money starts chasing too few goods.

2. **Deficit Financing and increase in Money Supply** - Mounting government expenditure financed through deficit financing i.e. printing of fresh currency

directly pushes up money supply, increases purchasing power and breeds inflation without a corresponding rise in the supply of goods and services.

3. **Black Money** - Unaccounted or black money plays an important role in pushing up prices by pushing up demand and conspicuous consumption. Black money estimated to be close to 50 percent of India's GDP has a major role in fuelling demand and leading to rise in prices.

4. **Population Pressure** - Growing population also puts pressure on aggregate demand and on the price level. Indian Economy is particularly affected due to pressure of population which results in expansion in demand for goods and services in general and results in inflationary pressures if supply fails to match demand.

5. **Forex Reserves** - Rise in forex reserves leads to corresponding increase in domestic money supply and fuels inflation. As more foreign exchange comes into the country, RBI has to create corresponding domestic money.

6. Excess liquidity created in the system due to monetary and fiscal stimulus packages.

7. Rising incomes and wages in India have also pushed up demand.

II. **Cost-Push and Supply-Related Factors**

1. Fluctuations in output and supply - Prices tend to rise when there occurs violent fluctuation in output or when there occurs speculative hoarding of the available output. In the Indian context, shortfalls in agricultural and industrial production are more often observed, leading to scarcity of goods and rise in price level. Seasonal factors play a very important role in creating shortages of agricultural goods like fruits, vegetables, food grains from time to time.

2. Rise in wages, which is greater than the rise in productivity, pushes up costs and thereby pushes up the prices too. This also acts on the Demand-Pull side because rising wages lead to rising demand also.

3. Indirect taxes are known to have cost-cascading effects. These taxes, like excise and custom duties, raise the cost of production as these taxes are on commodities. Also, State level taxes like VAT, Entry Tax, Octroi lead to rise in final prices of goods and services.

4. Infrastructural bottlenecks like shortage of power, transportation etc. raise per unit cost of production and hence the price level in general. These have played a very important role in fuelling inflation in a country like India as these shortages raise per unit cost of both production and distribution.

5. Increase in administered prices like procurement prices of food grains, petroleum prices and such other prices which are arbitrarily fixed by the government tend to push up the price level, as they have a high weightage in the price index.

6. Rise in import prices pushes up domestic price level and leads to what is called import Cost-Push inflation. This factor is becoming increasingly important in a globalised scenario.

While the above Cost-Push factors are generalised set of factors built into the Indian Economy, there are other important factors causing distortions in the entire supply chain from time to time and creating artificial scarcity as well as critical supply bottleneck. These are as follows:

1. Cartelisation practices adopted by traders of essential commodities, particularly manufactured goods like cement, steel.

2. Entry barriers along the supply chain including high fees charged by State Governments under the APMC Act which proves prohibitive for new entrants to trade their products in the regulated markets.

3. Sudden flow of speculative capital into thin commodity futures markets, which has some impact on the spot market also.

4. High margins appropriated by middlemen all across the supply chain.

5. Costlier imports of some food items like edible oils.

6. Rise in international prices of crude oil.

7. Speculation, hoarding, black marketing practices of Indian traders to take advantage of rising prices.

8. Depreciation of the rupee making imports costlier. This has been a very important factor in the last one year as the rupee depreciated to a record low level.

CONSEQUENCES OF INFLATION

1. Apart from uncertainties in production, inflation causes certain serious

imbalances in the economy. Price relationships are badly distorted and production pattern goes out of line with demand. As a result, there is misallocation of resources. Capital resources available in the country get diverted from long-term to short-term uses and production shifts from essential to non-essential goods. For example, if prices of non-essential goods are rising and those of essential goods are not, it will be more profitable to invest resources for the production of non-essential goods.

2. Inflation leads to recession in many sectors of the economy. For example, as a result of inflation, prices of certain articles of consumption in India have increased to very high levels forcing demand for such goods to decline. Similarly, inflation brings about a squeeze in purchasing power so that people incur increasing expenditure on essential goods, while expenditure on the other goods declines and causes recession in industries producing these goods.

3. Rise in price level has eroded the volume of investment in real terms in India on many occasions and has led to distortions in cost calculations. Inflation also leads to rise in interest rates as interest rates move in tandem to keep abreast of inflation to put a curb on rise in demand for loans from banks.

4. The most serious effect of inflation is on distribution of incomes which makes rich better off and poor worse off. Profit earners gain because of inflation while people with fixed incomes tend to lose. Inflation has thus brought about shifts in the distribution of income in favour of the rich and perpetuated inequalities.

5. Inflation also breeds corruption, black-marketing and speculation and is responsible for generation of black money.

6. Inflation mars incentive for hard work because common man cannot meet his ends with limited income.

7. Inflation also makes exports costlier and to that extent may impact balance of payments and exchange rate.

8. Rise in interest rates due to inflation can also make borrowing by the government costly and thereby raise fiscal deficit.

Measurement of Inflation

In India, inflation is measured on the basis of both the Wholesale Price Index (WPI) and the Consumer Price Index for Industrial Workers called the (CPI-IW). There are three distinct series of Consumer Price Index (CPI) used for monitoring retail price movements on a monthly basis. These are CPI (IW), CPI (AL) i.e. Agricultural labourers and CPI (UNME) i.e. Urban Non-Manual Employees. Of these, CPI (IW) is the most popular and is also used for grant of Dearness Allowance to Central Government employees. The base year for CPI (IW) is 2001. The CPI (IW) is used for measuring the cost of living of a common man as influenced by inflation, while the WPI is used for measuring the rate of inflation. An interesting distinction between the two is that the WPI is purely a commodity index and does not take into account services for measuring inflation, whereas CPI (IW) includes both commodities and services, though the number of commodities covered by it is much smaller as compared to the WPI. Besides, the CPI (IW) is based on retail prices and hence captures the impact of prices of selected essential goods and services on the household budget. CPI (IW) has been replaced by a new CPI (N) constructed at the national level.

Main features of WPI which is constructed on a monthly basis are as follows:

1. Base year for this index is 2004-05.
2. Number of commodities covered is 676.
3. Number of commodities comprising the manufactured commodities group is 555.
4. Weightage of manufactured commodities in the Index is 65 percent.
5. Weightage of primary articles, including food articles is a little over 20 per cent.
6. Weightage of fuel, light and electricity is 15 percent.

This index is prepared by the Office of the Economic Advisor, Department of Industrial Policy and Promotion.

As compared to the WPI, the CPI has much larger weightage of primary articles, which is as high as 50 percent. This implies that impact of food inflation is reflected much more prominently in CPI than in WPI as WPI gives just 24 percent weight to these articles. Moreover, seasonal fluctuations in the prices of these commodities have a relatively lesser influence on WPI.

New Consumer Price Index (base 2010):

A new CPI was launched in January, 2011 called CPI (N) with base year 2010. CPI (N) is the average of CPI (R) and CPI (U) - Rural and Urban which is also prepared separately: The CPI (N) is based on five major commodity groups at present. The new series is based on a weighting scheme derived from Consumer Expenditure Survey Data and has an all India character. This index is prepared by C.S.O. (Ministry of Statistics and Programme implementation) and is based on NSS data on consumer expenditure surveys. Base year for this index has been shifted to 2012.

Inflation in India is a structural as well as a monetary phenomenon. In the short term, localised demand-supply imbalances in wage goods, often due to seasonal variations in production - coupled with market rigidities and regulatory failures have supported inflationary expectations that have resulted in a more widespread impact on the consumers than the initial inflationary impulse.

In the medium to long-term, the movement and outcome of monetary aggregates such as the money supply and reference interest rates of the financial systems have influenced aggregate demand and consequently changes in price levels in the economy. The latter considerations and the influence of global commodity prices on the domestic prices have become more important with the opening and growing integration of the Indian economy with the rest of the world.

Both the WPI and CPI have shown a declining trend for most part of 2015. The WPI has been in the negative zone for a large part of the year while CPI has also come down in the range of 3-5 per cent, which is below the target set by the RBI for its policy of inflation targeting at a level of 6 per cent by January, 2016. However, since August 2015 the CPI has been gradually rising from 3.7 percent in August to 5.6 percent in December 2015, mainly due to rising food prices.

A major reason for declining inflation has been a massive fall in international prices of petroleum products. Also, commodity prices have been falling the world over since 2014 as brought out by the World Bank Commodity Price Index.

Food Inflation:

The food index consists of two sub components, namely primary food articles and manufactured food products. The overall weight of the composite food index in the WPI is 24.31 percent, comprising primary food articles with a weight of 14.34 percent and

manufactured food products with a weight of 9.97 percent. A major concern in the domestic economy has been a sharp rise in food price inflation in recent years. Inflation in primary food articles has mainly been driven by rice, vegetables, potatoes, onions, fruits, milk, eggs, meat and fish, condiments and spices, and tea while in manufactured groups it has been vanaspati oil, groundnut oil, sunflower oil, etc. Main items of concern in non-food inflation are raw cotton, raw jute, raw silk, copra, castor seed, sunflower, raw rubber, copper ore, zinc, iron ore, cotton textiles, petrochemicals, intermediate and industrial machinery and machine tools. In the fuel and power group the major contribution to inflation is from mineral oils accounting for over 90 percent.

Inflation has been a major cause of concern for both the government and the RBI. A number of measures have been adopted to contain inflation. Measures like higher interest rates to contain demand on the one hand and incentives to producers to improve supply on the other. Also, certain other measures have been taken that shield vulnerable consumers (such as targeted subsidies for below poverty line (BPL) families), those that protect all against a price rise (such as subsidizing diesel prices), and those that shut down markets so as to suppress price signals (such as shutting down commodity futures markets) or to quell price increases (such as export bans).

Broadly, two sets of measures are adopted to curb inflation as follows:

I. **Monetary Policy:** This policy adopts quantitative and qualitative credit control measures to address inflation. By and large, the RBI uses Repo Rate and Cash Reserve Ratio to tame inflation from time to time.

II. **Fiscal Policy:** This is used mainly by way of reduction of import duties on essential items as well as selective reduction of excise duties.

However, both these policies may have limited impact on controlling inflation. As such, more often the government adopts several administrative measures to control inflation, which are as follows:

1. Levy obligation in respect of all imported raw sugar and white/refined sugar removed.
2. Export of non-basmati rice, edible oils (except coconut oil and forest based oil) and pulses (except Kabuli chana) banned.
3. Minimum export price (MEP) used to regulate exports of onion and basmati rice.
4. Futures trading in rice, urad and tur suspended by the Forward Market

Commission.

5. Export of Onions (all varieties) not permitted with effect from 22 December 2010 until further orders.
6. Full exemption from basic custom duty, special additional duty and education cess provided to onions and shallots.
7. NAFED and NCCF have undertaken sale of onions at subsidised prices from their retail outlets at various locations, with suitable budgetary support being provided to them for this purpose.

Measures with a wider horizon include the following:

(a) A scheme to support the State Governments in the setting up of farmers' mandis and mobile bazaars and improve the functioning of civil supplies corporations and cooperatives will be finalised urgently.

(b) The existing PDS to be suitably strengthened through computerization and other steps, including opening more procurement windows across the country. The government has identified 22 essential commodities whose prices are being monitored to contain food inflation.

(c) State Governments urged to review the APMC Acts and, in particular, consider exempting horticultural products from their purview thereby mitigating marketing and distribution bottlenecks in this crucial sector. State Governments will also be urged to consider waiving mandi tax, octroi and other local levies which impede smooth movement of essential commodities, as well as to reduce commission agent charges.

(d) Investment to be encouraged in supply chains, including provisions for cold storages, which will be dovetailed with organised retail chains for quicker and more efficient distribution of farm products, minimising wastages. The DIPP, Department of Food and Public Distribution, Ministry of Food Processing Industries and the Planning Commission will jointly work out schemes for this purpose.

Producer Price Index

A Producer Price Index (PPI) measures price change from producers' perspective as against the Consumer Price Index (CPI), which measures price change

from consumers' perspective. Most of the countries have switched over to PPI from WPI. In PPI, only basic prices are used for compilation, while taxes, trade margins and transport costs are excluded. PPIs, apart from measuring inflation, are used as deflators in the compilation of GDP. PPI is considered to be a better measure of inflation as price changes at crude and intermediate stages can be tracked before it creeps into the finished goods stage.

The government has set up a committee to devise an all-new barometer called the Producer Price Index as it is readying to consign the Wholesale Price Index to history; months after Reserve Bank of India started giving more importance to the upgraded Consumer Price Index as a gauge of inflation. The proposed Index will seek to bring India's inflation gauge on a par with international standards, with PPI tracking changes at the producer level for both goods and services and CPI providing details of retail prices. The 13 member committee is headed by Professor BN Goldar and has representation from various central ministries and departments.

PPI is a totally new concept for India. It involves a lot of work. WPI includes taxes while PPI tracks inflation minus tax component. The most important part of PPI will be services, as currently there is no index tracking inflation in the sector that contributes about 55% to India's GDP.

PPI will track average change over time in selling prices received by domestic producers for their output for both goods and services while WPI tracks transaction only at the wholesale level for goods.

Prices included in PPI are from the first commercial transaction for many products and some services. The committee will outline methodology and timelines for launch of PPI series to initially run parallel to WPI and later replace it.

Data is likely to prove a key constraint for the committee since services sector data is not collected on a regular basis.

An experimental services price index is already in place for four services- railways, banking, postal and telecom. However the challenge will be to get regular timely data to formalize the index.

Chaudhury, who headed the panel on WPI revision, recommended doing away with the excise duty component on manufactured goods while computing WPI to track

pure price changes. This will keep inflation free of effects of tax fluctuations and bring it closer to PPI.

PPI is a better indicator of price changes as it tracks average change over time in selling prices received by domestic producers for their output for both goods and services.

Some of the challenges in computing PPI may be as follows:

- Though it contributes about 55% to economy, there is no services sector database. Government has, on an experimental basis, come out with a services price index for railways, postal, banking and telecom.
- Agriculture data: Most transactions happen at the mandi so tracking producer level prices is a challenge.
- Historical data: WPI has been around for decades, with a large historical database, and will be difficult to replace.

Inflation Targeting

Inflation Targeting implies that the principal objective of monetary policy of the central bank is to achieve price stability by setting a certain numerical target of inflation or range of inflation within a particular time frame. Some countries have adopted point targets while others are following a more flexible target of inflation within a band/range.

New Zealand was the first country to adopt inflation targeting in 1989 and at present most advanced nations as well as some developing nations adopt inflation targeting. A Committee headed by Urjit Patel has recommended inflation targeting to be adopted by the RBI under which it should target a rate of inflation of 6 percent by January, 2016 based on CPI. Thereafter, it should target annual rate of inflation at 4 percent with a band of 2 percent plus or minus.

The Committee recommendations have been accepted and the RBI has set inflation target of 6 percent by January 2016. The targeted rate of inflation is to be set jointly by the RBI and the government. The responsibility of achieving the target would rest on the RBI on the demand side and on the government on the supply side.

Thus, monetary policy and fiscal policy would converge for achieving the target and thus ensure accountability and transparency in the conduct of monetary policy.

Inflation beyond a point works like a monster and distorts growth, welfare, investments, savings and overall credibility of the economy.

Services Price Index

Given the importance of the service sector, there is need to develop service price indices for selected service sectors, particularly in the National Accounts framework. Accordingly, the Office of the Economic Advisor, Department of Industrial Policy and Promotion, Ministry of Commerce and Industry has been in the process of developing Service Sector price indices as per international best practices. Studies are being commissioned for selected services like road transport, railways, air transport, port, banking, insurance, posts, telecommunications, business services and trade services to develop service price index. The need for a services sector price index in India is warranted by the growing dominance of the sector in the economy. The WPI covers only commodities.

Real Estate/Housing Price Index

Rapid urbanisation and high economic growth experienced by the urban centres in the last few years has resulted in an upsurge in property values. The importance of facilitating supply of affordable housing to the people and the necessity of designing a right mix of policy initiatives to encourage house acquisition highlights the necessity of tracking the movement of residential house prices. Moreover, the real estate assets are a significant component of the wealth of the private sector and financial freedom allowed for acquiring this wealth is one of the important financial obligations of this sector. For the financial intermediaries also, lending for residential houses has been a significant component of their credit portfolio. The authentic data on the real estate sector in the country, development of a credible database on market driven price trends and price index of market-segments have, therefore, emerged as a crucial elements of market development and for enhancing the efficiency of market processes. The NHB RESIDEX is an initiative of the National Housing Bank (NHB) to provide an index of residential prices in India across cities and over time. The NHB RESIDEX now covers 15 cities and is updated and released on a quarterly basis with 2007 as base year.

BASE EFFECT: This is defined on the basis of the impact of rise in price level in the previous year over the corresponding rise in the price level in the current year. It is calculated by dividing the rise in price index in the current year (numerator) by price

index in the previous year. For example, price index may be 100, 130, 160 and 190 in 2010, 2011, 2012 and 2013 respectively.

Inflation rate in 2011 will be 30/100 x 100 = 30 per cent

Inflation rate in 2012 will be 30/130 x 100 = 23 per cent

Inflation rate in 2013 will be 30/160 x 100 = 18.75 per cent

PHILLIPS CURVE: The curve given by A.W. Phillip of New Zealand establishes relationship between rate of inflation and rate of unemployment. It states that there is an inverse relationship between the two in the sense that if a nation wants low rate of inflation it must be prepared for a high rate of unemployment and vice versa.

CHAPTER – 10

STOCK EXCHANGES AND COMMODITY EXCHANGES

Stock market as the heart of a country's capital market is an important index of a country's corporate performance and growth prospects. The behaviour of stock market in India is determined by two major indices viz. SENSEX and NIFTY. The former is with reference to the Bombay Stock Exchange while the latter belongs to the National Stock Exchange. The difference in their overall valuation is due to differences in the base year of the two. The SENSEX comprises of shares of 30 most traded and profitable companies while the NIFTY comprises of 50 most liquid stocks.

These two indices performed well in 2014 and major part of 2015. It was only after August 2015 that moderation began due to devaluation of Chinese Yuan and adoption of cheap money policy by China by cutting repo rate and CRR.

Apart from these two national level stock exchanges, there are regional stock exchanges also. These regional stock exchanges have promoted in recent years The Inter-Connected Stock Exchange of India Ltd. to provide a national level market of stocks traded at regional stock exchanges.

In addition, there is the Indo Next promoted by Bombay Stock Exchange and some of the regional stock exchanges with the objective of providing greater liquidity to stocks listed on regional exchanges.

There is also the MCX Stock Exchange Limited set up in 2008 which not only deals in currency derivatives but also in shares. A parallel stock exchange was also set up for currency derivatives in 2010 called United Stock Exchange of India.

A special stock exchange set up for over two decades is the Over the Counter Exchange of India called OTCEI which deals mainly with trading of shares of small companies.

Capital market has a very important role to play in a country's capital formation as it helps mobilization of savings, raising long term capital, mobilizing foreign capital, promoting industrial growth and acting as a guide to corporate performance.

SEBI has been very proactive in recent years to bring about transparency and sophistication in capital market and protect investors' interests particularly minority share holders and make listed companies more accountable towards investors.

Amendments have been carried out in 2014 in the SEBI Act which enable it to easily access call data records to prove insider trading charges. These new norms for insider trading have been framed on the recommendations of Sodhi panel set up by SEBI.

Insider trading refers to trading of a company's securities by individuals with access to non-public information about the company. The Sodhi panel has suggested tighter provisions, making it mandatory for listed companies to adopt a code of internal procedures.

The Securities and Exchange Board of India (SEBI) has tightened rules to keep a check on insider trading and made it cheaper for small investors to participate in companies' delisting process. As part of the revamp in insider trading norms, the capital market regulator has barred directors and key management personnel of listed companies from trading in futures and options contracts of the company. It has also put the onus on the accused to prove that he or she was not in possession of unpublished price-sensitive information. Under the new delisting rules, investors will be able to tender their shares on stock exchanges. This move will help reduce their tax outgo. It also approved the proposal to review the policy in respect of barring a company or its promoters categorised as wilful defaulters from raising capital after going through public consultation process. The regulator has tightened the two-decade old insider-trading rules to align them with International practices.

The amendment also empowers SEBI to regulate any such financial alliance of Rs.100 crore and above, which is formed to attract funds from investors, which may not have been overseen by any other regulator under law. Such alliance implies any privately pooled investment fund in the form of a trust or company.

Apart from trading in stocks and shares, there are instruments like corporate bonds, debentures and gilt-edged securities which are prominently traded in the stock exchange. The Gilt-edged market deals in government securities/securities guaranteed by the Government central/state. Gilt-edged implies risk-free or least risk securities i.e. securities on which interest as well as principal amount is assured. Thus, gilt-edged also

implies best quality. The RBI plays a dominant role in the gilt edged market through its open market operations. Many private sector mutual funds have lately entered this market because of risk-free returns and have floated gilt-edged funds for the purpose.

Stock markets the world over function on the basis of rolling settlement under which a transaction involving sale and purchase of shares in the secondary market has to be completed within a fixed number of days by paying money/buying shares. This is known as rolling settlement which in most advanced countries is T+1 which implies one day after the day of transaction. In India it is T+2.

Rolling Settlement is based on Demat trading i.e. paperless trading through the depository mechanism wherein transfer/sale/purchase of shares takes place in the electronic mode on the basis of code numbers allotted to investors for which a demat account has to be opened with a bank/financial institution/broking firm. The SEBI has made it mandatory for all shares to be transacted in demat mode. This is done through the depositories mechanism.

Stock exchanges also provide a platform for hedging future risks. This is known as Futures Trading which is carried out on the basis of futures and options in a regulated manner for identified scrips under the supervision of a stock exchange which lays down the necessary guidelines. This is a calculated speculation carried out under Securities Contracts Act in the form of what are called Futures and Options.

Trading in shares and bonds takes place both in Primary and Secondary segments of the capital market. The former deals with new securities and the latter with securities of existing companies.

Establishment of credit rating agencies like CRISIL, ICRA and CARE has also been a very significant development in the capital market to assess financial health of different companies for the benefit of investors at large, as ratings by agencies helps investors evaluate the risk of their investments.

Merchant Banking is another important development in India's capital market which implies that many Indian and foreign banks have started providing financial services such as underwriting of shares, organizing the entire share issue on behalf of companies, consultancy services etc.

An important segment of stock markets in the last two decades are the mutual funds which enable small investors with low risk appetite to invest in different shares

without exposing themselves to these shares and instead investing in the units of mutual funds as these units are related to a basket of various shares. There are mainly two categories of Mutual Funds viz. close-ended funds and open-ended funds. The former issue units (comprising of different shares as well as bonds) up to a certain fixed data after which these units can only be bought/sold in the secondary market. The latter are funds which offer units without any closing date so that any time one can buy/sell these units.

Alternative Investment Funds (AIFs)

Anything alternate to traditional form of investments is called alternative investments. Generally, the term includes private equity and hedge funds. In India, such funds were first notified in 2012 under SEBI (Alternative Investment Fund Regulations 2012).

It refers to any privately pooled investment fund, (whether from Indian or foreign sources), in the form of a trust or a company or a body corporate or a Limited Liability Partnership (LLP) which are not presently covered by any Regulation of SEBI governing fund management (like, Regulations governing Mutual Fund or Collective Investment Scheme) nor coming under the direct regulation of any other sectoral regulators in India- IRDA, PFRDA, RBI. Hence, in India, AIFs are private funds which are otherwise not coming under the jurisdiction of any regulatory agency in India. Thus, AIFs include venture Capital Fund, hedge funds, private equity funds, commodity funds, Debt Funds, infrastructure funds, etc.

One AIF can float several schemes. Investments in these funds are largely by institutions, high net worth individuals and corporate. Development of capital market in a country brings with it a variety of new players/ investors as well as financial instruments to invest in. For example, there are venture capitalists, Angel investors, Hedge funds etc. A brief account of these is given below: -

Angel Investor: An angel investor is an affluent individual who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity. They are usually found among an entrepreneur's family and friends. They provide a one-time injection of seed money or ongoing support to carry the company through difficult times. They give more favourable terms than other lenders, as they are usually investing in the person rather than the viability of the business. They are focused on helping the

business succeed, rather than reaping a huge profit from their investment. Angel investors are essentially the opposite of a venture capitalist as the latter part with capital in a company mainly to earn high profits.

Hedge Fund: Hedge fund is an investment vehicle that pools capital from a number of investors and invests in securities and other instruments. It is administered by a professional management firm, and often structured as a limited partnership, limited liability company, or similar vehicle. Hedge funds are generally distinct from mutual funds as the majority of hedge funds invest in relatively liquid assets and are not regulated by any regulators as they operate independently and invest in a wide range of investments.

Reforms in the capital market in the last two decades have been mainly as follows:

(i) Introduction of paperless trading called DEMAT.
(ii) Rolling Settlement.
(iii) Statutory status given to SEBI.
(iv) Permission given to Foreign Institutional Investors (FIIs) to invest in Indian Stock Markets.
(v) Online trading.
(vi) Regulation of Participatory Notes

Also the SEBI and RBI have framed guidelines and rules for a new category of foreign investors called Qualified Foreign Investors (QFIs), which can be an individual or a group residing abroad who has to be FATF compliant. This category existed earlier also but was not given a separate status as they were allowed to invest only through FIIs registered with SEBI but can now invest directly since 2012. Financial Action Task Force (FATF) is an inter-governmental body set up in 1989 to prevent money laundering and financing of terrorist activities.

Commodity Exchanges:

While Stock Exchanges deal with trading in shares and bonds, commodity exchanges deal with trading in commodities including commodity futures. The regulator for these exchanges is the Forward Markets Commission (FMC) which permits futures trading in nearly 125 commodities. Like stock exchanges, there are two categories of Commodity Exchanges viz. national level and regional level. There are as many as five national level exchanges namely, National Commodity and Derivatives Exchange

Limited (NCDEX), Multi-Commodity Exchange (MCX), Indian Commodity Exchange (ICEX), ACE Derivatives and Commodity Exchange and National Multi Commodity Exchange of India.

A significant development in late 2015 was that the FMC was merged with SEBI.

Pension Sector Reforms

The pension sector reforms were initiated in India to establish a solid and sustainable social security arrangement in the country against the backdrop that only about 12-13 percent of the total workforce was covered by any formal social security system. The New Pension System (NPS), which was introduced by the Government from January 1, 2004 for new entrants to the Central Government service, except the Armed Forces, was to be extended gradually to the remaining 87 percent of the total workforce on a voluntary basis. The design features of the NPS are self-sustainability and scalability. Based on individual choice, it is envisaged as a low-cost and efficient pension system backed by sound regulation. As a pure "Defined Contribution" product with no defined benefit element, returns would be totally market-related. It could provide various investment options and choices to individuals to switch over from one investment option to another or from one fund manager to another, subject to certain regulatory restrictions.

Pension Fund Regulatory and Development Authority (PFRDA), set up as a regulatory body for the pension sector, was engaged in the process of putting in place the full NPS architecture, consisting of a Central Recordkeeping Agency, Pension Fund Managers and Trustee Bank. The National Securities Depository Limited, selected as the Central Recordkeeping Agency (CRA) by PFRDA, also commenced its operations. State Bank of India, UTI Asset Management Company and Life Insurance Corporation were appointed as Pension Fund sponsors under the NPS.

The NPS has been extended to new segments (autonomous bodies, State Governments and unorganized sector) and micro-pension initiatives have been introduced. NPS has been well received by the State Governments.

Following the Government's decision in 2008 to extend the NPS to all citizens including the unorganized sector workers, the PFRDA rolled out the NPS architecture during 2009-10. As part of this exercise, PFRDA appointed six pension fund managers and 22 points of presence for managing NPS contributions pertaining to all citizens, and

has made available the NPS to all citizens of India from May 1, 2009. Tier-I of the NPS constituting the non-withdrawable pension account has become operational from May 1, 2009 and Tier-II (withdrawable account) of the NPS account became operational subsequently. It is expected to help realize the full potential of the NPS in terms of economies of scale and offer benefits to the subscribers in terms of lower fees and charges and high returns.

In terms of investment guidelines, pension fund managers manage three separate schemes. The asset classes specified for the purpose consist of (i) equity, (ii) government securities and (iii) credit risk bearing fixed income instruments.

It has been decided that investment by an NPS participant in equity would be subject to a cap of 50 percent. The fund managers will invest only in index funds that replicate either BSE sensitive index or NSE Nifty 50 index. The subscriber will have the option to consciously decide the investment composition of NPS pension wealth. In case the subscriber is unable / unwilling to exercise any choice regarding asset allocation, his contribution will be invested in accordance with the "Auto Choice" option and according to a pre-defined portfolio.

The concept of retirement planning in India has for long been restricted to bank savings and the provident fund. Investors who are young and have the risk appetite should look at the equity option for the long term. This would ensure a good retirement corpus at the age of 60 years. Switching from one option to another is a great flexibility for investors.

The PFRDA is also seeking tax relief for NPS like EPFO products. Out of the total fund size, nearly 80 percent is government money. Barring two states, all the other state governments have notified joining NPS, whose mandate covers development of the pension sector as also framing regulations for the advancement of the NPS and protection of the interests of the subscribers.

CHAPTER – 11

WORLD TRADE ORGANISATION (WTO)

WTO was born as a result of Uruguay Round of GATT talks which started in 1986. The negotiations lasted eight years culminating in the final Act of December, 1993, which was mainly due to consensus document prepared by the Director General of GATT, Arthur Dunkel. This was subsequently popularly known as Dunkel Draft which brought a consensus on various issues among member nations. It was in April, 1994 that 124 countries signed the agreement at Marrakesh, Morocco for the establishment of WTO from 1st January, 1995. Uruguay Round comprised mandate to have negotiations in 6 major areas as follows:

(i) Free Trade in goods, called market access which was a continuation of the principle of GATT.

(ii) Free Trade in services called GATS – General Agreement on Trade in Services.

(iii) Trade Related Intellectual Property Rights (TRIPS).

(iv) Trade Related Investment Measures (TRIMs)

(v) Multi-Fibre Arrangement – this meant that developed countries would dismantle quotas which they had fixed since early 1970s for import of textiles from each developing country. Dismantling of these quotas would imply free trade in textiles.

(vi) Agreement on Agriculture which mainly related to subsidies given to agriculture both by developed and developing countries.

Other than these were issues, like dispute settlement, non-tariff barriers, national resource based products, safeguards and other types of custom duties, tropical products, etc.

Unlike its predecessor GATT, the WTO is a full-fledged body while GATT was just an agreement which had no provision for dispute settlement body. The present strength of WTO is 162 member nations. The highest decision-making authority is

WTO's Ministerial Conference, comprising Commerce Ministers of member countries which meets every two years for deciding various issues.

As many as 10 Ministerial Conferences have been held so far, the last one at Nairobi from December 12-17. Of these, the most important have been the first meet at Singapore (1996), the fourth at Doha, Qatar (2001), the ninth at Bali, Indonesia (2013) and the last one at Nairobi (2015).

Singapore meet dwelt largely on four issues viz. labour standards, investment and competition in international trade (called trade facilitation), information technology and international trade in textiles. Other than the issue of labour standards which the developing countries argued should not be a part of WTO but of International Labour Organisation (ILO) to which developed countries had to agree, other three issues were to be thrashed out in successive meetings of the Ministerial.

The most important conference was the DOHA meet. While there were strong pressures to launch a comprehensive round of negotiations including multilateral regimes on investment, competition policy, trade facilitation, government procurement and environment, India was opposed to over burdening of the multilateral trading system with non-trade or new issues on the agenda. In this conference, India underlined the need for resolving the implementation issues arising from the current agreements in a time bound manner before addressing new issues for negotiations.

The work programme aimed at reduction in customs tariffs and opening up of agriculture and services. Exporters of farm goods can expect to benefit from the reduction of domestic support and export subsidies in Europe and the U.S.

In this conference India made significant gains on public health concerns in the TRIPS agreement. The agreement over amendment to TRIPS, which would allow countries access to low price patented drugs in case of a public health emergency, was a victory for India.

The ninth conference at Bali reaffirmed India's leadership role among developing countries as India played a key role in arriving at a major agreement protecting its national interests.

In this agreement the WTO removed, by a special general council resolution, the perceived ambiguity over the permanency of a peace clause for the benefit of developing countries breaching limits set on product-specific support to agriculture. It also approved

a protocol on the trade facilitation agreement (TFA), meant to add $ 1 trillion to the global economy by easing customs rules.

The peace clause ensures that WTO members will not challenge developing countries' food security programmes at the WTO dispute settlement body until a permanent solution regarding this issue has been agreed on and adopted. Hence, the deal removes ambiguity over the permanency of a peace clause which ensures that members will not challenge food security programmes at WTO. The deal also approved a protocol on the trade facilitation, meant to add $ 1 trillion to global economy by easing customs rules and create 21 million jobs.

The deal would reduce transactions costs, red tape, and corruption at sea ports and cargo airports, by standardising norms, improving logistics and reducing delays in the movement of goods, which could raise global incomes by as much as 2 trillion dollars.

It was also agreed that food stockholding programmes in the developing world will not be subject to WTO dispute procedures, until a permanent agreement is arrived at a later date.

The Tenth WTO Ministerial Conference held in Nairobi from 12th to 17th December, 2015 secured a historic agreement on several trade initiatives and commitments. The rich countries view it as a breakthrough after 15 years of the Doha round, with six ministerial-level decisions on agriculture, cotton and other issues, including a commitment to abolish export subsidies for farm exports, public stockholding for food security purposes, a special safeguard mechanism for developing countries, measures related to cotton and preferential treatment for least developed countries in the area of services.

For India, which has held out on the reaffirmation of the declaration and decisions ~~adopted at the Doha meeting in 2001, the outcome may well be disappointing~~ because at stake was the right to provide subsidies to farmers in a country where 85 per cent of farmers have holdings of less than five acres, and that too given the backdrop of rural distress after successive years of drought. At the Nairobi conference, members of developed countries have committed to removing export subsidies immediately, except for a handful of agricultural products, while developing countries will do it by 2018, with flexibility to cover marketing and transport costs for agriculture exports until the end of

2023. These relate to livelihood issues in an economy like India, even as some of the experiments with the Direct Benefits Transfer scheme show that it can gradually eliminate inefficiencies.

Equally important, or more so from India's viewpoint, was the issue of a special safeguard mechanism or SSM that allow India to raise tariffs to protect the interests of local farmers against surges in imports. The ministerial decision on SSM for developing countries recognises that they will have the right to temporarily increase tariffs in the face of import surges while committing members to engage constructively in finding a permanent solution on public stockholding for food security.

At the Nairobi Ministerial India expressed its 'thorough' disappointment over non-reaffirmation to conclude 14-year-old Doha round pacts, even as the WTO meeting managed to win a commitment to allow developing nations to use special safeguards to protect farmers against import surges.

After hectic negotiations, the WTO Trade Ministers concluded their talks without any commitment on rich countries being asked to check their domestic subsidies. Besides, rich nations refused to budge on their long-standing position of putting the onus on developing countries with regard to duties.

However, the members of the global trade body agreed on a commitment for giving the developing nations a right to take recourse to Special Safeguard Mechanism (SSM) to protect their farmers – a long-standing demand of India.

Lobbying by India and other developing countries also led to reaffirmation to decisions taken earlier at WTO on the issue of public stockholding. India ensured that the Bali and the General Council's November 2014 decision on public stockholding which gives protection to farmers has been reaffirmed in no uncertain terms. However, India was disappointed that notwithstanding a large group – India, China, G33, African Union – all of whom insisted that Doha has to be reaffirmed, the reaffirmation has been divided.

India, along with other developing countries, especially most members of the G33, LDCs, the Africa Group and the ACP, wanted a reaffirmation of the mandate of the Doha Round. While the majority were in favour of such reaffirmation, a few members opposed the reaffirmation of the Doha mandate. This marks a significant departure from the fundamental WTO principle of consensus-based decision making. Notwithstanding

the difficulty in the negotiations, the draft Declaration reflects India's demand for a reaffirmation from all members to work towards a permanent solution on public stockholding.

The five-page declaration at the Nairobi meeting, which also marked the 20th anniversary since the establishment of the WTO, underlined the crucial importance of the multilateral rules-based trading system and reaffirmed the principles and objectives set out in the Marrakesh Agreement establishing the WTO.

International trade can play a role towards achieving sustainable, robust and balanced growth for all. Members pledged to strengthen the multilateral trading system so that it provides a strong impetus to inclusive prosperity and welfare for all members and responds to the specific development needs of developing country members, in particular the least developed country members. Acknowledging that the majority of WTO members are developing countries, the declaration resolved to place their needs and interests at the centre of the work in the WTO.

The Nairobi meet was, however, a frustrating experience for India because it could not muster support from some of the developing countries on not including new issues in the WTO. In this regard, it is a victory for developed countries which succeeded in adding new issues related to investment, competition and public / government procurement. The developed world is also patting itself on the back on the special safeguard mechanism by which countries can raise tariffs if there is a sudden fall in the prices of commodities in the international market. But this is also to be reviewed later.

India's real disappointment is that the Nairobi meet virtually brings to an end the so called Doha Development Agenda (DDA). India succeeded in getting assurances on its food security policy and it also got developed countries to agree to a continuation of the Special Safeguard Mechanism (SSM).

For its part, the US did not make a secret of its dislike for the DDA and its strategic trade policy objectives in the face of China's rise. The US decision to actively pursue mega-regional plurilateral trade deals under the umbrella of the Trans-Pacific Partnership and the Trans-Atlantic Trade and Investment Partnership was aimed at bypassing the WTO in taking the trade liberalisation agenda beyond the confines of the DDA.

A look at the functioning of the WTO in the last two decades clearly brings out that the most debated issue has been that of farm subsidies. For member countries, these subsidies have been capped at 10 per cent of the value of agricultural produce, while developed countries continue to circumvent this limit by disguising these subsidies into green box, blue box and amber box. Green.box subsidies are not considered trade distorting like subsidies for environmental and conservation programmes, research funding, execution, disaster relief, etc.

Amber box is considered trade distorting as these are subsidies used for domestic support. It is these subsidies which developed countries use predominantly and disguise them in other forms to circumvent WTO limit of 5-10 per cent of the value of agricultural produce.

Blue box subsidies are payments made to farmers to leave their land fallow for environmental concerns.

Another debated issue has been that of services under GATS. India has opened much larger number of services to Foreign Service providers than other developing countries. For example, India has opened banking, insurance, telecom, shipping, aviation and a lot of other services to foreign service providers. India's concern over the years has also been that an important service under GATS viz. movement of labour from one country to another has been opened by developed countries which could permit Indian professionals and labour to seek jobs in developed countries.

Another issue that has bothered India and developing countries is that the developed world has sought to link reduction of subsidies in agriculture to corresponding reduction of tariffs/duties by developing countries on manufactured goods on the basis of a non-linear Swiss formula. This issue is popularly known as NAMA – Non-Agricultural Market Access. The non-linear Swiss formula requires much larger reduction of import duties on manufactured goods by India as India already has very high duties.

CHAPTER – 12

FOREIGN TRADE

The pattern of a country's foreign trade is determined on the basis of its composition and its direction. Composition implies what a country exports and what it imports. Direction implies countries to which it exports and countries from which it imports.

COMPOSITION OF TRADE

The commodity composition of India's trade has undergone many changes since liberalisation and has been driven by trade policy, movements in international prices, and the changing pattern of domestic demand. Manufactured goods constitute the bulk of exports - over 63 per cent in recent years followed by crude and petroleum products (including coal) with a 20 per cent share, and agriculture and allied products with a share of 13.7 per cent. The top seven product groups accounting for nearly 90 per cent of India's total exports are petroleum products, gems and jewellery, agriculture and allied products, textiles and allied products, chemicals and related products, transport equipment and machinery.

Growth in exports of petroleum and agriculture and allied products which had been in positive territory for the last four years, turned negative from 2014-15. Gems and jewellery exports also exhibited a declining trend from 2012-13 along with electronic goods. Some sectors like transport equipment; machinery, chemicals and related products, textile and allied products and base metals registered positive growth in exports.

Marine products and leather and leather manufactures recorded relatively high growth in 2012-13, 2013-14 and 2014-15 (April-January). While the shares in terms of nominal value of exports (conversely imports may be high in some sectors, the import (export) component may also be high and therefore it would be instructive to look at value added.

One of the major items in India's import basket is the POL group, which accounted for 36.6 per cent of India's total imports in 2013-14. However, there was moderation in international crude prices since early 2014-15 which continued to decline

fast to touch US 40 dollars a barrel by December 2015 which helped to contain India's deficit. Other major imports of India are capital goods, gold and silver and pearls and precious metals.

Direction of Trade

There has been significant market diversification in India's trade in recent years – a process that has helped in coping with the sluggish global demand, which owes to a great extent to the weakness in the euro zone. Region-wise, India's export shares to Europe and America have declined over the years – from 23.6 per cent and 20.1 per cent respectively in 2004-05 to 18.6 per cent and 17.2 per cent respectively in 2013-14. Conversely, the shares of India's exports to Asia and Africa have increased from 47.9 per cent and 6.7 per cent respectively in 2004-05 to 50 per cent and 11 per cent respectively in 2014-15. The change in direction immediately prior to the global financial crisis and since 1010-11 indicates the process of diversification underway. A comparison of India's trade in the pre-crisis (2004-05 to 2007-08) and post-crisis period (2010-11 to 2013-14) shows that India's exports and imports from Europe, the USA, and Singapore have declined, while its trade with Asia and Africa has increased.

In 2014-15 (April-December), India's exports to the European region grew by only 0.2 per cent while India's exports to Africa and America grew by 12.9 and 14.5 per cent respectively and to Asia, a major destination accounting for nearly 50 per cent of India's exports, by 2.2 per cent in 2014-15. Within Asia, India's exports to South Asia grew by 23.8 per cent (mainly due to high export growth to Sri Lanka, Nepal, and Bangladesh) and 8.8 per cent in the case of West Asia-Gulf Cooperation Council (GCC) (UAE, Saudi Arabia and others). India's exports to other regions of Asia witnessed a contraction – declining by 4.4 per cent to North East Asia (consisting of China, Hong Kong, Japan), 7.2 per cent to the Association of South East Asian Nations (ASEAN) (consisting of Singapore, Indonesia, Thailand, Malaysia), and 8.5 per cent to Other West Asia (Iran, Israel, and others) – in 2014-15. Country-wise, India's exports to the USA and UAE – major destinations with a share in India's total exports of 12.5 per cent and 9.7 per cent respectively in 2013-14 grew by 11.2 per cent and 11.9 per cent in 2014-15. However, India's exports to China (4.7 per cent share) and Belgium (2.0 per cent share) declined by 14.7 per cent and 10.7 per cent during the same period. Since 2012-13, there has been a contraction in India's exports to Singapore and Indonesia.

The share of Europe in India's imports also declined from 23.0 per cent in 2004-05 to 15.8 per cent in 2013-14 while the shares of Asia and Africa increased substantially from 35.6 per cent and 3.6 per cent in 2004-05 to 60.7 per cent and 8.1 per cent respectively in 2013-14. The share of America in India's imports has also increased from 8.8 per cent to 12.8 per cent during the same period. China is the major source of India's imports, accounting for 11.3 per cent of India's total imports, followed by Saudi Arabia (8.1 per cent share), the UAE (6.5 per cent share), and the USA (5.0 per cent share). In 2014-15, India's imports from China grew by nearly 20 per cent but there was contraction in India's imports from Saudi Arabia, USA and the UAE.

Exports have been a drag on India's growth story in 2015. The only consolation has been a falling rupee which depreciated by over 4 per cent in 2015 giving relief to select export sectors to earn more dollars. Traders are feeling the pinch and worried policy makers are looking for measures to boost exports. Low commodity prices and a global slowdown, driven by a sagging Chinese economy have also led to India's exports falling to their lowest levels in last five years.

In November, 2015 exports fell for 12th straight month by 24.4 per cent to 20 billion dollars. In October, exports fell by 17.5 per cent to 21.35 billion dollars with contraction in all but ten of the 30 major commodities. At the same time 19 of the 30 import sectors also saw a fall during these months. There was a decline of 30.2 per cent in imports which fell to 29.8 billion dollars in the month of November ensuring that trade deficit narrowed to 9.8 billion dollars against 16.2 billion dollars a year ago.

For the first eleven months of the calendar year 2015, exports reached 243.7 billion dollars against 323 billion dollars for the whole of 2014. Gold imports showed sharpest decline of 59.5 per cent in October, 2015. Also, imports of coal and fertilisers were subdued so that along with low prices of crude oil they helped contain trade deficit.

The fall in exports was led by iron ore which declined by 57 per cent followed by engineering goods (11.6 per cent), gems and jewellery and chemicals.

India's oil imports fell 45 per cent during October, 2015 and imports of chemicals 20.5 per cent as well as iron and steel by 4 per cent. The non-oil imports during October 2015 were 10 per cent lower in October 2015.

The government adopted some SOS measures in late October by raising support to outbound shipments of more products under the Merchandise Exports from India

Scheme (MEIS). It introduced 110 new tariff lines and increased the duty drawback benefit rates or the country coverage, or both, for 2228 existing tariff lines as it stepped up efforts to contain fall in exports.

While falling imports have come to the rescue of India's trade deficit, the decline in non-oil imports is worrisome as it means weakening of economic activity, including investment, putting a question mark on economic recovery.

India is rapidly integrating with the global economy and slowing world trade hurts exports. In this scenario, sops, interest subvention and enhanced duty drawback are unlikely to work much. World trade is expected to trail World GDP growth this year so that the focus must shift to raising domestic production and consumption which requires meaningful reforms to step up investment in infrastructure, boost productivity and make the economy more efficient. As cheaper Chinese goods flood world markets, India's export competitiveness will also take a hit. Focus on projects like Make in India can also help to revive domestic demand.

CHAPTER – 13

BALANCE OF PAYMENTS

Economics dictionary defines Balance of Payments as a systematic record of all economic transactions of a nation with the outside world. It tells us what a nation receives from the outside world and what it gives to the outside world including international financial institutions. Transactions are divided into two broad groups (a) Current Account; and (b) Capital Account. The Current account is made up of trade in goods (so called visible trade) and in services as well as profits and interest earned from overseas (so called invisible trade). It is the current account that is generally referred to in discussion of the state of Balance of Payment of a nation. The capital account is made up of such items as investment, borrowings and grants.

While trade accounts of the balance of payments is a simple statement of a country's imports and exports of goods, the invisibles account comprises (a) services (b) transfers/remittances and (c) income. Services include travel and tourism, telecom, computer, finances, transportation and services rendered by professionals. Transfers include remittances from Indians working abroad. Income receipts are those earned by nationals overseas like interest, profits, dividends, royalty, etc. by companies, individuals and the government. When compared with remittances to other countries, India has been one of the highest recipients of remittances from its citizens working abroad.

For all purposes, India's overall current account has been sustained over the years by invisible receipts which have shown a surplus in the sense that what India has earned on this account has been more than what India has paid on this account abroad. However, trade account has by and large been a concern as imports have always been more than exports so that India has always struggled with trade deficit. This implies that in the overall current account (trade/visible plus invisible account), there has no doubt been deficit but this deficit would have been much higher if India did not have a surplus on invisible account.

Recent developments in India's balance of payments suggest that two significant developments at the international level viz. drastic fall in oil prices and falling commodity prices have brought India's current account deficit to below 2 per cent although export growth rate has fallen successively in the 12 months of the entire 2015. Correspondingly

even imports have been falling due to the above two global developments as well as stringent measures adopted to check-rising gold imports. Simultaneously, there has been a surge in capital inflows – both of portfolio and direct investment. Slowdown in Chinese economy has also partly contributed to this. India has come out of that phase of external shocks after 2008 global financial crisis which saw India's current account deficit soar to a high level of over 5 per cent and the rupee touching Rs.70 to a dollar. Volatility was continuing in the value of the rupee throughout 2015 mainly due to the relative strengthening of the dollar vis-à-vis all currencies as a result of robust growth of the US economy.

Foreign Exchange Reserves

The shrinking import bill has improved the foreign exchange reserves adequacy levels. The cushion of foreign exchange reserves that ranged between $ 330 billion and $ 350 billion through 2015, have been adequate to fund more than 10 months' imports through most part of the year.

Import cover, a measure of a nation's ability to support its economy and how it traded with the rest of the world, rose to a five-year high, which could provide yet another buffer against any hit on the currency in the event of an outflow due to the Fed rate increase.

After touching 12 months of imports in February 2015, import cover of reserves has touched a level that is adequate to cover 12 months of imports in November 2015. These are the highest levels since 2010 when the number of months' imports that the reserves could cover was in double digits.

This improvement has been possible despite volatile capital flows as foreign portfolio investors have pulled out large part of their investments in the Indian markets this year, anticipating a hike in policy rates by the US Federal Reserve.

The (import cover) adequacy of India's forex reserves has improved both due to RBI's proactive management in absorbing surplus foreign capital inflows, the government's initiatives which have resulted in large inflows and a fortuitous drop in commodities prices, especially oil, which has inter alia reduced imports bills.

The higher import cover will help RBI in stabilising currency volatility with the ability to fight speculative attacks arising from global triggers like sustained Fed rate hikes and shocks from China.

The Reserve Bank of India has been regularly intervening in the currency markets and managing capital flows to maintain a desirable level of the exchange rate, which in turn also influences the level of reserves.

Despite volatility in the global markets, RBI has been able to keep the rupee in a manageable band while mopping up dollars to create higher reserves. The central banks' goal is to build reserves that exceed the country's external debt at around $ 440 billion now.

Exchange rate of the rupee against the dollar has no doubt depreciated in recent years but the depreciation has been lower relative to other currencies like the Russian rouble as well as Brazilian, Mexican, Indonesian and South African currencies vis-à-vis US dollar.

Effective exchange rates are summary indicators of movement in the exchange rate of home currency against a basket of currencies of trade partner countries and are considered to be an indicator of international competitiveness. The real effective exchange rate (REER) indices are used as indicator of external competitiveness of the country over a period of time. The nominal effective exchange rate (NEER) is the weighted geometric average of the bilateral nominal exchange rates of the home currency in terms of foreign currencies. REER is defined as a weighted geometric average of nominal exchange rates of the home currency in terms of the foreign currencies adjusted for relative price differential. Although the rupee has depreciated against the US dollar, in terms of NEER (36 currencies) it appreciated by nearly 2 per cent. Similarly, REER also appreciated by over 5 per cent.

External Debt

As per the latest data, India's external debt stock increased by US $ 13.7 billion (3.1 per cent) to US $ 455.9 billion at end-September 2014 over the end-March 2014 level. The rise in external debt was on account of higher long-term debt, particularly commercial borrowings and NRI deposits. The maturity profile of India's external debt indicates the dominance of long-term borrowings. At end-September 2014, long-term debt accounted for 81.1 per cent of the total external debt vis-à-vis 79.8 per cent at end-March 2014. The share of short-term debt in total external debt declined from 20.2 per cent to 18.9 per cent.

The currency composition of India's total external debt shows that the share of US dollar-denominated debt in external debt stock continued to be the highest at 60.1 per cent followed by Indian rupee (24.2 per cent), special drawing rights (SDR) (6.5 per cent), Japanese yen (4.5 per cent), and euro (3.0 per cent) denominated. The currency composition of government (sovereign) debt indicates predominance of SDR-denominated debt (33.5 per cent), which is attributable to borrowing from the International Development Association (IDA), i.e. the soft loan window of the World Bank under the multilateral agencies, and SDR allocations by the International Monetary Fund (IMF). Government (sovereign) external debt was US $ 88.4 billion. It accounted for 19.4 per cent of India's total external debt. Non-government external debt amounted to US $ 367.5 billion which was 80.6 per cent of total external debt.

Over the years, India's external debt stock has witnessed structural change in terms of composition. The proportion of concessional in total debt declined from 42.9 per cent (average) during the period 1991-2000 to 28.1 per cent in 2001-10 and further to 9.8 per cent at end-September 2014. The dominance of non-government debt in total external debt is evident from the fact that such debt accounted for 65.6 per cent of total debt during the 2000s decade, vis-à-vis 45.3 per cent in the 1990s. Non-government debt accounted for over 70 per cent of total debt in the last five years and stood at 80.6 per cent at end-September 2014. India's foreign exchange reserves provided a cover of 68.9 per cent to the total external debt stock at end-September 2014 vis-à-vis 68.8 per cent at end-March 2014. The ratio of short-term external debt to foreign exchange reserves was 27.5 per cent at end-September 2014 as against 29.3 per cent at end-March 2014. The ratio of concessional debt to total external debt declined steadily and stood at 9.8 per cent at end-September 2015 vis-à-vis 10.5 per cent at end-march 2014.

India's external debt has remained within manageable limits as indicated by the external debt to GDP ratio of 23.5 per cent and debt service ratio of 5.9 per cent in 2014-15. The prudent external debt management policy of the Government of India has helped in containing rise in external debt and maintaining a comfortable external debt position. The policy continues to focus on monitoring long and short-term debt, raising sovereign loans on concessional terms with longer maturities, regulating ECBs through end-use, all-in-cost, and maturity restrictions; and rationalising interest rates on NRI deposits.

Cross-country comparison of external debt based on the World Bank's International Debt Statistics 2015, which contains the external debt data for the year 2013, indicates that India continues to be among the less vulnerable countries. India's key debt indicators compare well with other indebted developing countries. The ratio of India's external debt stock to gross national income at 23.0 per cent was the sixth lowest. In terms of the cover provided by foreign exchange reserves to external debt, India's position was sixth highest at 64.7 per cent.

Special Economic Zones

The government wants to end tax breaks for SEZs as part of the clean-up drive to lower the corporate tax rate to 25 per cent. Units in SEZs enjoy 100% exemption from income tax on export profits for the first five years, 50% for the next five years and 50% of the ploughed-back export profits in the last five years. The government must ensure that it does not renege on the promise of the 15-year tax break offered to existing units. These units should be given time to adjust, considering that the internal rate of return on investment would have been worked out factoring in the tax break. Also, a clear roadmap on the phase-out of exemptions, put in public domain for feedback, will help decision-making.

The SEZ policy, approved in 2000, was meant to set up enclaves that would create their own infrastructure, manufacturing and transport networks, to promote export-oriented production. Companies made a beeline to milk the tax breaks, but course-correction is warranted now to dispense with special enclaves. The entire country should become an SEZ if India is serious about raising its share in manufacturing. This is eminently feasible with robust infrastructure, efficient administration and transition to a goods and services tax that eliminates cascading of taxes.

CHAPTER – 14

FOREIGN INVESTMENT

Many countries which are ranked developed countries at present like Japan, Korea, Singapore, etc. had relied heavily upon foreign investment in the initial years of their development, as foreign investment not only helps build a country's forex reserves but more importantly builds infrastructure and brings state-of-the-art technology for manufacturing various products as well as for services. In a globalised world, foreign investment has a still greater role as it also boosts a country's stock markets as well as corporate performance.

Foreign investment is of two categories viz., Foreign Direct Investment and Foreign Portfolio Investment. The former comprises investment by foreign companies (generally MNCs) in manufacturing goods (consumer goods and capital goods), construction, infrastructure, services like banking, insurance, aviation, shipping and a host of others. In a large number of cases, such investments came along with latest technology used by foreign companies which also enhances productivity and motivates domestic companies to emulate foreign companies.

The latter form of foreign investment called Portfolio Investment comes mainly by way of investment in a country's stock market by foreign investors who invest in shares, bonds, debentures, including government bonds and mutual funds to make capital gains.

The Department of Industrial Policy and Promotion is the nodal agency for foreign investment policy. However, RBI is the nodal agency for regulating inflow and outflow of Foreign Direct Investment as well as Foreign Portfolio Investment – the latter along with SEBI.

The total amount of foreign direct investment which comes into India at any given time is calculated by adding the following three components:

(i) Equity investment i.e. foreign shareholding in a domestic Indian company (which can be from 10 per cent to 100 per cent).

(ii) Retained earnings of companies (i.e. undistributed profits) which are reinvested.

(iii) Inter-Company debt transactions among associated companies i.e. loan taken by a foreign company from its associated company for investing in the company.

The highest of these components is Equity Investment which implies what percentage of total investment in a domestic company in India is by a foreign company. This is technically known as FDI cap. If this cap is 100 per cent, it means that entire investment in a domestic company can be by a foreign company. Generally, 100 per cent cap in India is permitted for infrastructure and high technology sectors and those for which there may be acute shortage of domestic resources. FDI caps up to 49 percent imply that majority control is in the hands of domestic company.

There are three routes through which FDI inflows come to India as follows: -

(i) Automatic route of the RBI under which a foreign investor does not require any prior approval before investing in India. He only has to inform the RBI within one month of bringing in his capital and again within one month of issuing shares to non-residents. Thus, this is considered a hassle-free route. Nearly 55 percent of the total FDI received so far has come through this route.

(ii) FIPB route under which a foreign investor has to seek prior approval of the apex board viz., Foreign Investment Promotion Board before he can invest in India. Generally, the following categories of proposals and activities / industries fall under this route:

(a) Activities requiring industrial license under the Industries (Development and Regulation) Act;

(b) Proposals where the foreign investor had an existing joint venture technical collaboration / trademark agreement in the same field of activity;

(c) Proposals for acquisition of shares in an Indian company in the financial services sector and where SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 are attracted; and

(d) All proposals falling outside notified sectoral policy / caps or under sectors in which FDI is not permitted.

(iii) NRIs and Overseas Corporate Bodies (OCB) - This route implies that the Government provides incentives to NRI's and OCB's (most of which are owned

by NRI's) to invest in India. In certain sectors, policy prescriptions are relaxed to attract investments by NRI's.

More and more sectors/industries have been brought under the automatic route in keeping with the government policy of procedural simplification. Such of the sectors like infrastructure (ports, bridges, roads, highways) and a few others in which government finds scarcity of domestic resources have been permitted 100 percent FDI under the automatic route.

In order to address the problem of high current account deficit, the government opened floodgates to FDI by raising caps of FDI for various sectors as well as by relaxing norms and conditions for some of these sectors. These changes are as follows:-

(i) FDI cap in telecom sector raised from 74 percent to 100 percent. Also, FDI up to 49 percent in this sector shall be through automatic route.

(ii) FDI cap in insurance raised from 26 percent to 49 percent subject to Parliamentary approval.

(iii) FDI cap in defence production raised from 26 percent to 49 percent on a case-by-case basis for state-of-the art technology.

(iv) FDI cap in single brand retail which is 100 percent has been modified whereby up to 49 percent will be allowed under automatic route and rest through FIPB.

(v) FDI cap in Asset Reconstruction Companies raised from 74% to 100 percent.

(vi) FDI in petroleum refining up to 49% will now be under automatic route as, against FIPB route earlier. Also, FDI in power exchanges up to 49 percent under automatic route against FIPB earlier.

(vii) FDI up to 100 percent in courier services under automatic route.

(viii) FDI in credit information firms raised from 49 to 74 percent.

~~Also norms and conditions for FDI in multi brand retail have been relaxed.~~

In a major policy decision taken in November, 2015 the government further opened up several key sectors including defence, construction, civil aviation and media to foreign investment, eased norms for businesses such as single-brand retail and private banking and allowed FIPB to clear proposals up to Rs. 5000 crore from Rs. 3000 crore earlier. In defence, the government has allowed foreign investment up to 49 per

cent under the automatic route which was earlier under government approval route. Investment over 49 per cent will now be cleared by the FIPB instead of the Cabinet Committee on Security. Portfolio investors as well as foreign venture capital firms can also invest up to 49 per cent as against 24 percent earlier. With private investment stuttering in construction, the government has done away with entry and exit barriers. For example, area restriction of 20,000 sq metres and minimum capitalisation requirement of 5 million US dollars to be brought in within six months of commencement of business have been removed. Further, foreign investors can exit and repatriate investments before a project is completed but with a lock-in of three years.

FDI limits have also been hiked in teleports, DTH and cable networks to 100 per cent with government approval required beyond 49 per cent. Further, news and current affairs TV channels and FM radio can now bring in upto 49 per cent FDI under the government route against 26 per cent earlier. For non-news and down-linking of TV channels, 100 per cent FDI has been permitted under the automatic route. In banking, the government has introduced full-fungibility, meaning FIIs/FPIs/QFIs can now invest up to the sectoral limit of 74 per cent subject to the condition that there is no change in control and management of the private bank. Manufacturers have been allowed to sell them products through E-Commerce without government approval.

Another major booster for companies such as IKEA, a single-brand retail company with 100 per cent FDI, is the announcement of dilution in sourcing norms. Earlier, such companies had to ensure sourcing to the extent of 30 per cent of the value of goods from the date of FDI receipt. Now, it has been changed to opening of the first store. Also, in case of "state of the art" and "cutting edge technology" ventures under the single brand route sourcing norms have been relaxed. All these measures imply "Minimum government maximum governance".

Economic reforms since 1991 have also focused on attracting foreign investment in different sectors and in this regard more sectors have been brought under the automatic route. Besides, measures like simplification of procedures, enactment of FEMA, raising FDI caps, entering into Bilateral Free Trade Agreements have been adopted. Special bodies like the FIPC (Foreign Investment Promotion Council) and FIIA (Foreign Investment Implementation Authority) have been set up.

Also, a joint sector company viz. 'Invest India' has been set up with capital participation by both public and private sector for promoting FDI. This company provides

investment information to foreign investors and works on 'no profit no loss' basis. Its initial capital of Rs. 1000 crore is shared between FICCI and the government in the ratio of 51:49.

Under the current policy regime, there are three broad entry options for foreign direct investors. In a few sectors, FDI is not permitted (negative list); in another small category of sectors, foreign investment is permitted only till a specified level of foreign equity participation; and the third category, comprising all the other sectors, is where foreign investment up to 100 percent of equity participation is allowed. The third category has two subsets – one consisting of sectors where automatic approval is granted for FDI (often foreign equity participation less than 100 percent) and the other consisting of sectors where prior approval from the Foreign Investment Promotion Board (FIPB) is required. FDI policy changes increasingly reflect the requirements of industry and are based on stakeholders' consultation. Upfront listing of negative sectors has helped focus on reform areas, which are reflected in buoyant FDI inflows.

Foreign Direct Investment brings a large number of benefits to the recipient country like precious foreign exchange, bridging saving –investment gap in a developing country, state-of-the-art technology, expansion of markets, bridging trade gap and promoting exports, generating competition between foreign & domestic investors, generating employment, enhancing productive capacity, etc.

However, FDI can also bring with it a large number of problems and potential dangers for the recipient country like, threat to economic and political sovereignty, cut-throat competition, escalation of land and property prices, suppression of domestic entrepreneurs through their financial muscle by the MNCs, transfer pricing practices of MNCs.

The FDI policy has to be carefully adopted to get the best out of foreign investment as foreign investment is like a match stick - a nation can light up its economy or burn its economy depending upon the use to which it puts in FDI. Sectors that attracted highest FDI during April-September, 2015 were computer software and hardware, trading, services and automobile and telecommunications. India needs about one trillion US dollars by March, 2017 to overhaul infrastructure like ports, airports and highways so as to boost growth.

Singapore replaced Mauritius as the top FDI source during the first half (April-September) of 2015-16 with total FDI of Rs. 43096 crore as against Rs. 23,490 crore which came from Mauritius. A total of 6.74 billion US dollars of foreign investment was attracted by India during 2014-15 of which 34 per cent came from Mauritius.

Foreign investment from Singapore has more than doubled since last year mainly due to DTAA with Singapore which incorporates Limitation of Benefit Clause which has prescribed comfort to foreign investors based there. Overall, since the year 2000, Singapore accounts for 15 per cent of total FDI received from April 2000 to September 2015.

FDI in Multi brand retail

A contentious issue in recent years has been opening FDI in multi-brand retail. This sector was opened in 2013 permitting FDI up to 51 per cent with certain conditions regarding their operations and sourcing norms.

According to ICRIER (Indian Council for Research in International Economic Relations) Report, India's total retail sector is estimated at close to 600 billion US dollars, with the un-organised sector accounting for over 90 percent.

Opening of FDI in retail will benefit the economy as follows:

- Investment in warehouses and cold storage chains will get a boost which will cut waste in agricultural produce.
- Boost for agricultural infrastructure.
- Elimination of high-margin middlemen which will benefit farmers on the one hand and consumers on the other.
- Better hygiene and quality products for consumers.
- Inflow of foreign capital and foreign exchange.
- Integration with global economy,
- Backward and forward linkage effects which will foster greater inter-dependence between agriculture, industry and service sectors.
- Generation of large scale employment as a result of backward and forward linkage effects.

Apprehensions that opening up this sector will deprive millions of small neighbourhood retailers of their livelihood and generate large scale unemployment have been dispelled by ICRIER study which reveals inherent benefits enjoyed by local retailers like catering to local tastes, sale on credit, convenient shopping timings, proximity, etc. due to which they will survive and be least affected.

However, a global report released in August, 2012 is at crossroads with ICRIER study and points to the dangers of ushering in FDI in the sector without adequate safeguards. The report has been brought out by Swiss-based UNI Global Union on the basis of business practices of Wal-Mart in some countries. The report points out, inter alia, that without adequate safeguards in place, FDI in multi brand retail will lead to widespread displacement and poor treatment of Indian workers in retail, logistics, agriculture and manufacturing.

Portfolio Investment

India opened its economy to Portfolio Investment for the first time in 1993. Foreign investors are permitted to invest in India's stock market by way of buying shares of Indian companies, bonds/debentures of Indian companies and even in mutual funds. They are also permitted to invest in government securities. Portfolio investment in India comes through three routes viz., (i) Foreign Institutional Investors (FIIs) (ii) ADRs/GDRs; (iii) Offshore Funds and NRIs. Of these, FII is the predominant route followed by GDRs/ADRs.

Foreign institutional investors include investors like pension funds, mutual funds, investment trusts, asset management companies, investment bankers, investment funds, charitable trusts and foundations, endowment funds, etc. The government has liberalized its policy towards portfolio investment according to which foreign individual investors are also permitted to invest in the Indian Stock Market but only in mutual funds and not direct purchase of shares. Also, foreign individual investors are permitted to invest directly in the stock market. However, these would be qualified foreign investors who would have to satisfy KYC norms of the RBI and SEBI and also will have to be FATF (Financial Action Task Force) compliant.

Under the existing framework, portfolio investment in any company through, various routes such as FIIs (24%), NRIs (10%) and QFIs (10%) is allowed up to 44%. Once these categories are clubbed together as FPI, theoretically, foreign funds up to

44% can be invested in a firm without being classified as FDI. The idea is to minimize the number of caps, and clearly define FDI and FII. In a major policy change, the government, laid down, that in accordance with global practice if an investor has a stake of 10% or less in a company, it will be treated as FII, while a stake of more than 10%, will be treated as FDI.

The portfolio investment route of American Depository Receipts (ADRs) and Global Depository Receipts (GDRs) implies that shares of Indian Companies are sold in American Stock Exchanges and European Stock Exchanges respectively.

Global Depository Receipt is a dollar dominated instrument traded on a stock exchange in Europe or the USA or both. It represents a certain number of underlying equity share which are dominated in rupees. The shares are issued by an Indian company to an intermediary called the depository in whose name the shares are registered. It is the depository which subsequently issues the GDRs. The physical possession of the equity shares is with another intermediary called the custodian who is an agent of the depository. For all purposes, GDRs provide another avenue to Indian companies to access global capital markets.

The Indian capital market is not only buoyant, but is also endowed with a strong regulatory framework, which is conducive to greater longer term FII participation. Furthermore, stable flows (i.e. all form of capital flows excluding portfolio flows and short term credits) still accounted for around 60 percent of total capital flow in 2014-2015.

There was substantial inflow of portfolio investment in India in 2013 and 2014 largely due to the programme of Quantitative Easing (QE) adopted by the US under which the US Federal Bank printed ultra cheap money by buying bonds so as to spur the economy. A large part of this cheap money was invested by global investors in emerging markets including India. In one of the most aggressive buying sprees since liberalisation foreign investors pumped in large funds into Indian stocks in the last three years. This is more than the combined investment in the nine years beginning 2001, and dwarfs all that was invested in the boom years of 2005-08.

If FIIs maintain their pace of investments, they would pump in about $100 billion in next five years (2014-2018) and buy out large chunks of the stocks that they own today. If foreigners want to buy each and every stock that they own today, out of what is remaining in their foreign investment quota, they can only pump in another $100 billion.

Then there will be no stock available for them in the markets. This is not an implausible scenario.

Tobin Tax

Tobin tax, named after its profounder, Nobel laureate James Tobin in 1970's is a tax on portfolio investment which is in the nature of volatile cross-border financial flows moving from one country to another in search of quick profits. Such flows are estimated to be of the order of 5 trillion US dollars per day.

The tax has come into sharper focus after the 2008 global financial meltdown which was inter-alia attributed to such flows. Some high ranking Indian policy makers have been staunch supporters of imposing such a tax in India in recent years.

It is argued by its proponents that a tax on short term capital flows would make exchange rates reflect to a large extent long term fundamentals relative to short term expectations and risk. The tax has the potential to be applicable not only to currency markets but other markets as well, particularly after the experience with regard to global financial crisis.

Such a tax is considered necessary to recover the bailout cost incurred by the government to avoid collapse in the financial sector. Besides, the ill-effects of excessive financialisation have been realized now.

The volume of foreign exchange transactions is 5 trillion dollars a day, while only 2% of this is necessary for financing trade in goods and services and the remaining 98 percent may be purely speculative flows. Such a tax would also bring revenue to the government apart from reducing the incidence of short term flight of capital.

However, the desirability of the tax has been questioned on several grounds. Some point out that it is not possible to differentiate between the 'real variable', driving exchange rate such as gross domestic product, employment, output and 'unreal ones' that create speculative bubbles. Others say that the Tobin Tax creates economic distortions to the market mechanism.

Some policy makers have argued that it would be appropriate to improve underlying policies and environment which generate such volatility in financial markets, rather than impose a tax. There are others who have argued that such a tax increases

transaction costs. However, such a tax is likely to be small, relative to the expected profits out of the market activity.

Undoubtedly, such inflows have to be treated with caution as this is in the nature of 'Hot Money' or 'Fly by Night' money which has a tendency to fly out of the country due to various economic and political uncertainties that may appear in an economy. As such, it has the inherent potential of causing financial instability and mayhem in the financial world. Therefore, most nations regulate such flows through various measures. Yet, such flows can cause major turbulence in financial markets. In India such flows are regulated by measures like Short term capital gains tax, ceiling on such investments as a ratio of a company's paid up capital, sectoral ceiling etc.

HEDGE funds and Participatory Notes

Hedge funds are funds set up by individuals and institutions to hedge risks and optimize returns. Many such funds have been set up by very wealthy individuals to invest funds across global stock markets to diversify risks and optimize returns. These funds are unregulated entities which are not regulated in any country including the USA. They operate through brokerage firms and, in India, also through FIIs.

This implies that FIIs may issue P-Notes to such funds so that through these P-Notes hedge funds would invest in shares of Indian Companies. By definition, P-Notes are offshore derivative instruments issued by FIIs to such of the entities (hedge funds) who wish to invest in the Indian Stock market but don't wish to disclose their identity and be regulated. These are not physically held by these entities.

P-Notes comprise nearly 15 percent of the total FII investments in India and have the potential to make Indian stock market volatile as they are not regulated by SEBI. Yet, the government has taken a lenient view of these and exempted them from the provisions of GAAR as it apprehends that any move to restrict P-Notes may drive away foreign investments.

Transfer Pricing and Advance Pricing Agreements

Transfer Pricing refers to the pricing of assets, tangible and intangible, services, and funds transferred within an organisation in cross-border transactions. In other words, transfer pricing is the price at which a company sells goods to its own parent or subsidiary. Tax administrations apply stringent rules to pricing of such transfers to prevent transfer of income from high tax jurisdiction to low tax jurisdictions to escape tax.

Multinational companies that have business in India have frequently complained against the aggressive tax administration in transfer pricing disputes that has led to increase in tax disputes.

Rules of Advanced Pricing Agreements (APAs) have been notified by the government to enable MNCs to negotiate with the Indian tax authorities on their potential tax liability with respect to their transactions with their local arms or the local company dealing with its parent, helping avoid frequent transfer pricing litigation with foreign companies which has soured investment sentiments.

An Advance Pricing Agreement (APA) is an agreement between a taxpayer and the tax authorities that allows both to set out in advance, the method of determining the transfer pricing for inter-company transactions, helping avoid post transaction disputes apart from giving Multinational companies (MNCs) certainty about their tax liability. These agreements are made in advance with respect to the pricing of the related party transactions of the taxpayer for a specified period of time.

APAs give taxpayers certainty about their transfer prices for their related party transactions helping cut litigation and trouble. The company seeking AGAs submits its detailed information about costs and margins to the tax authorities. Based on the information submitted and a comparison with what a similar arms length transaction would cost, tax authorities give their opinion.

The government has notified 'Safe Harbour' rules under which it will accept up to a tax liability of Rs. 500 crores whatever has been declared by a company under APAs, without any objection or threat of litigation. The transfer pricing dispute and a respective legislation to bring old deals under the tax net has been cited as major hindering factors for foreign investment. Indian laws state that companies have to sell goods to parent or subsidiary at the same price at which they sell these to third parties. In other words, the price at which it sells should be arm's length price.

The income tax department had filed a transfer pricing case against telecom major Vodafone in December, 2011. The company won the case in the Bombay High Court in late 2015 which brought relief to similar cases against some other MNCs as well. This verdict also sent favourable signal to foreign investors investing in India.

TAX HEAVENS AND DOUBLE TAXATION AVOIDANCE AGREEMETNS

Double Taxation Avoidance agreements entered into by India with nearly 70 countries imply that a foreign investor/company enjoys the option of paying Income tax/capital gains tax either in India or in any of these countries. The main objective of entering into such agreements is to attract foreign direct investment as many of these countries have zero or very low rates of taxation. Double Tax Avoidance Agreement (DTAA) means that any foreign investor has the option of paying tax either in India or in the country with which such agreement has been entered into. Most of the multinational corporations prefer to route their investments to India through Mauritius and other such countries with which India has DTAAs because foreign investors are not subjected to double taxation.

According to the Organisation for Economic Co-operation and Development (OECD), Mauritius is an important 'tax heaven'. Other tax havens are Cyprus, British Virginia, Cayman Islands, Bahamas, Hong Kong, Malta, etc. While there is no precise technical definition of a 'tax haven', they are typically characterised by low or zero taxation, a lack of transparency and a refusal to provide information to foreign tax authorities. Thus, they become a preferred route of investment by MNCs in other countries. Tax havens lead to tax avoidance. The most obvious method is for an individual to move to the tax haven country and become a resident for the purpose of paying taxes. Another way is to incorporate a business in the tax haven country and then move all the company's assets to it.

Any new income created by the incorporated company {or trust) would then be subject to taxation only in the tax haven country. For example, if investors from India incorporate firms in Mauritius, route money to these firms and then invest back to India, they would avoid paying taxes. If a company earned a profit of $ 500 million in India in a year, through this route it could avoid paying taxes of $150 million. Thus, tax havens help in 'round tripping' (also known as 'treaty shopping'). 'Round tripping' refers to routing of investments by a resident of one country or a firm through the other country back to the home country. Three major sources of round tripping in India in recent times have been Mauritius, Cyprus and UAE.

Estimates of the value of asset held in tax havens, by the super rich, is close to US $ 32 trillion. The United States tax authorities could be losing some $100 billion in tax revenues annually due to off-shore tax abuses. Other countries are also losing

considerable amount of tax revenues. On account of this reason, the G-20 leaders have denounced tax heavens and decided to impose sanctions against them. Typically, the DTAAs aim at avoidance of double taxation. However, certain countries impose "Limitation of Benefits" condition under which there has to be a certain minimum level of investment for enjoying tax benefits. India has this clause incorporated in its agreement with Singapore. The USA also has a provision under these agreements for imposing additional taxation. It is mainly due to three reasons that the world community has now launched its tirade against DTAAs. These are:

(1) Zero or low tax rates;

(2) Lack of transparency; and

(3) Refusal to share and exchange information and data with governments of other countries.

There is increasing evidence that these tax heavens have become harbingers of Black money due to their typical features mentioned above. Governments all over the world have initiated stronger measures to bring them to book and conform to international standards of disclosure and compliance. The group of G - 20 Nations has been in the forefront in this regard. On its part, the Indian Government has taken up a comprehensive review of all the DTAAs with various countries and made it mandatory that the revised agreements incorporate Tax Information Exchange Agreements as well as General Anti Avoidance Rules (GAAR) to ensure that only genuine investments flow through these countries.

Also, 'Limitation of Benefit' clause has been incorporated in major agreements which means that tax benefits are available only if investments are above a certain limit. The CBDT has also opened income tax units in some of these countries including Singapore and Mauritius to facilitate information exchange. Based on this information the department initiates recovery process here. The CBDT is also keeping a close watch on visits by Indian nationals to tax heavens some of which have disclosed names of some individuals.

The 'Limitation of Benefit' clause will ensure that specific operations which gain treaty benefits are denied tax concessions. India-Mauritius tax treaty provides that capital gains arising in India from investments into India from the island nation can only be taxed in Mauritius. Since Mauritius does not tax capital gains, investments that are

routed through the country escape capital gains tax. India's key concerns have been abuse of tax treaty by investors of a third country or Indian companies re-routing their investment through Mauritius, what is popularly called round-tripping. The treaty is in the process of revision to ensure transparency.

Limitation of Benefit clause is quite popular globally as some countries have conditions such as a minimum level of investment, listing on the local stock exchange, ceiling on turn over and minimum expenditure, local residents on company board, etc.

CHAPTER – 15

IMPORTANT DEVELOPMENTS AND SCHEMES – 2015-16

I. GOLD SCHEMES

The government launched three gold schemes in November, 2015 with the aim of reducing physical demand for the yellow metal and to bring into circulation the idle gold lying with households. These three schemes are (i) Gold monetisation Scheme (GMS) (ii) Sovereign Gold Bond Scheme; and (iii) Indian Gold Coin.

The GMS will offer resident Indians the option to deposit gold and earn interest of up to 2.5 per cent. The Sovereign Gold Bond Scheme will offer investors an interest rate of 2.75 per cent per annum for eight years on the paper bonds issued by the Government. These bonds will be issued from November 26 and sold through banks and designated post offices.

Under the Indian Gold Coin Scheme, the coin bears the Ashok Chakra on one side and has an engraving of Mahatma Gandhi on the other. These coins will be available in denominations of 5 gms and 10 gms. Also, 20 gm gold bar will be available via MMTC outlets across the country.

India has surpassed China as the world's largest gold consumer buying 562 tonnes of gold in the calendar year (up to November 2015) compared to China's 548 tonnes.

Gold Monetisation Scheme

Offering an interest between 2.25-2.5 per cent per annum on a minimum gold deposit of 30 gms by individuals, the scheme comes as a good option for individuals who are looking to monetise their gold which is lying idle. This is far better than previous such schemes that offered around 0.75 to 1 per cent in interest and the minimum deposit quantity of 200 grams, making it tough for small depositors to participate. The fact that the gold deposited will be exempted from wealth tax, capital gains and income tax on interest income also makes it attractive for investors.

Under the scheme, individuals will have to take their gold (bar, coin or jewellery) to the hallmarking centre where it will undergo purity tests. The depositor will then be told about the approximate amount of pure gold.

The gold then will pass through a fire assay test where it will be melted. Customers who agree to deposit the gold are not required to pay any fee and are provided with certificates by the collection centre, certifying the amount and purity of gold deposited. Based on the certificate, the bank will open a gold savings account and the customer's account will be credited with an equal quantity of gold. Under the scheme, banks will collect gold for up to 15 years.

Experts say that the biggest hurdle for the scheme is that Indians who buy gold in the form of jewellery are not very willing to part with it since it will be melted. So there is a possibility that people will at first show up with the gold they had bought as investments. Industry experts say that if the interest rate offered were higher at around 4 per cent (similar to the savings bank rate) then the scheme would have had higher chances of success.

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Sovereign Gold Bond

This is another scheme where investors can park their money in bonds backed by gold. It will be available in both Demat and paper form.

The bond will be issued by the Reserve Bank of India (RBI) on behalf of the Government of India and will be made available at bank branches and designated post offices across the country.

While the investment limit has been set at a maximum of 500 grams per person per year, the investment will offer an interest rate of 2.75 per cent per annum along with the capital gains linked to the appreciation in price of gold. Investors can also use the bonds as collateral for loan and sell it before its maturity since they would be listed and tradable on the exchanges.

Interest on gold bonds shall be taxable and capital gains tax shall also be taxable. The RBI has fixed the public issue price of sovereign gold bonds at Rs.2,684 per gram and the bonds will be issued in denominations of 5, 10, 50 and 100 grams of

gold or other denominations. Applications for investing in the bond will be accepted from November 5-20 and they will be issued on November 26. The KYC requirement for the bonds will be similar to that for the purchasing of physical gold.

While these bonds may look attractive, experts say that since the investment is just like investments in gold, one must stick to the asset allocation and not stretch beyond 10 per cent of the asset allocation into the metal.

India Gold Coin

For those looking to invest in gold in the form of coins, the government also issued an 'India Gold Coin' that would be available in denominations of 5 and 10 grams. Even a 20 gram bar or bullion will also be made available. The India gold coin is unique in many aspects and will carry advanced anti-counterfeit features and tamper proof packaging that will aid easy recycling. The coins would be distributed through designated and recognised MMTC outlets.

II. MASALA BONDS

The International Finance Corporation, an arm of the World Bank and a major global financial institution, issued what are popularly called 'Masala Bond' (a term synonymous with India as a country rich in spices) in September 2015 aimed at boosting funding for infrastructure like roads, power, airports, etc. The principal objective of IFC (as a subsidiary of the World Bank) is to foster private sector development in developing countries. These bonds marked the first rupee bonds listed on the London Stock Exchange and were issued under the IFC's 2 billion US dollars offshore rupee programme. This followed earlier offshore rupee issuances by IFC, in 2014-15. The vast majority of investors in the latest 'Masala Bonds' were European Insurance Companies. The IFC invested bond proceeds in an infrastructure bond issued by AXIS Bank which is a client of IFC.

It is important to note that IFC has seen its rupee-denominated borrowings in 'International Markets' surge to the top five in currency terms, nearly comparable to its yen-denominated borrowings and higher than Yuan-denominated borrowings. Two years back, India did not figure in the top five in the local currency denominated borrowings of IFC which has the distinction of being among the first multilateral institution to issue bonds in the local currencies of emerging markets. In all, IFC has issued bonds in 17

emerging markets currencies and has extended local-currency financing in more than 60 currencies through loans, swaps, guarantees, risk-sharing facilities and other such products.

Local currency denominated bonds are an alternative source of debt financing for the public and private sectors. Unlike ECBs, the Indian borrower issuing such bonds is not exposed to any currency risk and therefore the local currency bond markets can contribute to financial stability by reducing currency mismatches and extending the duration of debt. In fact, IFC has played a catalytic role in deepening India's capital markets through rupee-denominated bonds whose success has also prompted RBI to consider permitting local companies to issue similar bonds in offshore markets.

Most Indian companies have been borrowing money from overseas markets only in dollar denominated bonds or other currencies such as euro. However, if they start borrowing through offshore rupee bonds (like IFCs Masala Bond) it will allow companies to hedge currency fluctuation risks. For example, company's costs may rise sharply if the rupee's value weakens sharply during payback time compared to its value at the time of issuing the bonds. A rupee bond negates such risks and besides, interest rates are lower by about two per cent which helps companies cut costs.

The Indian Railways is also in the fray to issue rupee-denominated bonds and list these on the London Stock Exchange.

III. IMF INCLUDES CHINESE RENMINBI IN SPECIAL DRAWING RIGHTS (SDR)

The IMF Board announced in early December 2015 that the Chinese currency, popularly called Yuan, will be included as the fifth currency in its special Drawing Rights as an accounting unit that serves as IMFs de facto currency. There are only four other currencies which enjoy this distinction viz. the dollar, euro, pound and yen. By adding Yuan, the IMF effectively says that it considers the currency to be safe, reliable and freely usable. Many central banks follow this benchmark in measuring their reserves which countries hold to protect their economies in times of trouble. The Yuan will form part of Special Drawing Rights as from October 2016 and will therefore be one of the currencies used in the disbursement and repayment of international bailouts, denominated in the Fund's accounting unit like Greece's debt deal. The addition of Yuan

is likely to fuel demand for China's currency and Yuan denominated assets as central banks and foreign fund managers adjust their portfolios to reflect the Yuan's new status.

The heart of earning such credibility will be a track record showing that China will allow the value of Yuan to be set by the market rather than by the Central Committee in China. This in turn will reassure holders of Yuan reserves that China will pursue growth and stability oriented policies which is the ultimate source of a currency's strength. The IMF defines a global reserve currency on the basis of (a) whether the currency is widely used to make payments for international transactions and (b) whether it is widely traded in the principal exchange markets.

China is the first non-democratic country to have been included in SDRs.

In reality, the history of global reserve currencies is highly correlated with political stability. Thus, the British pound became a de facto global reserve currency during the 19th century era of the Pax Britannica, when the sun never set over the empire. Victory over Napoleon made Britain stable externally, and the gradual, mostly peaceful emergence of modern democracy made it stable within.

The dollar assumed the status after American victory in World War-II. Again, global hegemony was paired with internal democracy and the stability it brings. The euro and the yen share the feature of stability, in large part because the governments of Europe and Japan are protected from foreign threats by cooperative US security arrangements, and democratic governments ensure smooth transitions within.

There would be considerable benefits for India and the rest of the world if the Chinese state does let go of its grip on its financial system. Indian industry, along with that of many other countries, have cried themselves hoarse against what they believe to be Chinese imports powered by a deliberately devalued Yuan. In theory, this will no longer be the case as the yuan establishes its reserve credentials. The global economy will be a lot more stable if its stakeholders have more reserve currencies to play around with. India's recent experiences with runaway inflation, the backwash of financial bubbles in other parts of the world and lopsided interest rate policies have been partly consequences of the loose monetary policies of the West. A Chinese reserve currency, for example, would mean less demand for US bonds and make it harder for Washington to print money.

IV. FALL IN GLOBAL COMODITY PRICES

The last two years have been nightmare for commodities at the global level. Since the start of 2014, the average landed cost of crude imported by Indian refiners has fallen from $ 108.76 to $ 36.65 a barrel. The same period has seen the London Metal Exchange Index that tracks prices of six primary non-ferrous metals – aluminum, copper, zinc, lead, nickel and tin – shed nearly a third of its value, even as benchmark US Midwest hot rolled coil steel rates have collapsed from around $ 680 to $ 365 per tonne.

The same holds true for precious metals and agricultural commodities. The UN Food and Agriculture Organisations' food price index is also down from its December 2013 level of 206.2 and the all-time-high of 237.7 for February 2011 to a low of 157 in November, 2015.

There are broadly three reasons for this commodity meltdown. The first, of course, is China. The slow-down in the world's largest manufacturing economy has hit demand for everything from copper, nickel and aluminium to coal and iron ore. Given its share of global consumption, ranging between 50% and 75% in these industrial raw materials, the dragon sneezing has naturally led to Brazil, Australia, Indonesia, Chile and many other catching cold. Worse, the excess steelmaking and aluminium, zinc and copper smelting/refining capacities that came up during the boom have become a source of dumping, as Chinese producers are increasingly pushing overseas sales to offset stalling local demand growth.

The second is a strengthening US economy, alongside its emergence as a surplus oil producer, due to the shale revolution. In October 2013, US crude oil output hit 7.7 million barrels per day (mbpd), surpassing imports of 7.5 mbpd. Since then, its production has gone up further to an average of 9.4 mbpd, while imports have hovered at 7.3-7.4 mbpd. This turnaround in fortunes for a country that consumes a fifth of the world's oil – has been a significant contributor to the tumbling of crude prices. Simultaneously, the US economic recovery and the prospect of an imminent Federal Reserve interest rate hike have fostered a strong dollar, in turn, diminishing gold's safe-haven appeal.

The third factor is somewhat more complex, having to do with commodities being lumped together as a distinct 'asset class'. From the early 2000s commodities became trading vehicles for not just chocolate manufacturers, jewellers or airline companies

wanting to hedge against volatility in price of cocoa beans, bullion or fuel, but even for exchange-traded funds and other 'pure' investors having no direct production or dealing interests in them. At the height of the so-called emerging markets boom, the notional value of bullish investments in commodity index products monitored by the US Commodity Futures Trading Commission (USCFTC) totalled $ 256 billion in end-April 2011.

That tide has turned in the past two years, though, as index, pension and hedge funds have sharply cut their commodity exposures. The mounting selling pressure from funds has aggravated the crisis in commodity markets and also for governments, whether in Russia and Brazil or Argentina and Venezuela. Even the apparent rural backlash being faced by the Narendra Modi dispensation can be traced quite a bit to the global commodity crash affecting realizations for sugarcane cotton, rubber, rice, soya bean, or milk producers in India as well.

V. CREDIT DEFAULT SWAPS

The RBI permitted Credit Default Swaps in the Indian debt markets w.e.f. October, 2010. The objective of introducing CDS for corporate bonds is to provide market participants a tool to transfer and manage credit risk in an effective manner through redistribution of risk. CDS as a risk management product offers the participants the opportunity to hive off credit risk and also to assume credit risk which otherwise may not be possible. Since CDS have benefits like enhancing investment and borrowing opportunities and reducing transaction costs while allowing risk transfers, such a product would increase investors' interest in corporate bonds and would be beneficial to the development of the corporate bond market in India.

Guidelines on Credit Default Swaps for Corporate Bonds were issued by the RBI in 2011, outlining broad norms including the eligible participants and other requirements. It was also, indicated that market participants would have to follow the capital adequacy guidelines for CDS issued by their respective regulators. Subsequently, guidelines have been issued stating that NBFCs shall participate in CDS market only as users. As users, they are permitted to buy credit protection only to hedge their credit risk on the corporate bonds they hold. They are not permitted to sell protection and hence not permitted to enter into short positions in the CDS contracts. However, they are permitted to exit their

bought CDS positions by unwinding them with the original counterparty or by assigning them in favour of the buyer of the underlying bond.

A. CDS is a form of insurance against debt default. When an investor buys corporate (or government) bonds he/she faces the risks of default on part of the issuing agent. The investor can insure its investment in such bonds against default through a third party. The investor pays a premium to the party providing insurance. In the event of default by the bond issuer, the insurer would step in and pay the investor.

A CDS is just that insurance, which is bought by those who fear default and sold by those who believe it won't. CDS works like a derivative instrument that transfers risk from investors to those willing to bear it for a fee. By insuring against risks of default, credit default swaps allow riskier companies to raise funds. Also, it improves investment and borrowing opportunities by redistributing risk. Therefore, over all it helps increase credit flow and boast liquidity.

However, the third party insurer issuing credit default swaps must have the capital to pay-up in case of debt default. Therefore, the issuers of CDS must be well capitalized and have stringent regulations on their exposure or else in case of a default they will not be able to honour their commitment. This is what happened in the USA and led to worsening of the global melt down.

Speculators started buying CDS on even the bonds they did not hold, hoping to make good gains in the case of a default. This kind of CDS is known as naked CDS. In many cases, such investors were holding CDSs worth much more than underlying debt, betting on the defaults in the US sub-prime market. And when those defaults did happen, CDSs compounded the problem as the underwriters did not have the capital to honour their commitment.

The RBI has provided safeguards against such defaults as follows:

(i) CDSs will be subject to strict capital requirements, ensuring that the business is within prudent limits.

(ii) Naked CDS will not be allowed in India.

(iii) CDS buyers cannot buy insurance higher than the value of the underlying debt. These steps are expected to control speculation on default of bonds, restricting them to their proper use.

VI. SOVEREIGN WEALTH FUND

This is a fund set up by a government for the purpose of using its surplus force reserves more profitably by investing them in various market instruments including shares and stocks of different countries to get better yield. It is a State-owned Investment Fund composed of financial assets such as stocks, bonds, property, precious metals, or other financial instruments. Sovereign Wealth Fund invests globally Countries metals, or other financial instruments. Sovereign Wealth Fund invests globally Countries like China, Singapore, Abu Dhabi and a few others' having excess forex reserves have set up such funds. The Temasek Fund of Singapore and the Abu Dhabi Investment Authority are prominent examples of funds which are professionally managed. In India the practice for years has been to play safe so that RBI invests nearly 20 per cent of its forex reserves in treasury bonds of the US Government which yield very low return but are safe.

It will make far more sense for a part of the forex reserves to be held in the form of claims or production assets that have the capacity to yield higher returns. Higher returns normally come with higher risk. It would, of course, be a mistake to deploy forex reserves in a risky fashion. Yet, if the size of the portion of forex reserves that are used to buy claims on production assets abroad is sufficiently large to afford diversification of risk across sectors, economies and types of claims, the risk can be mitigated to a significant extent. The RBI which was reluctant for many years to set up such a fund has decided, to set up such a fund in the form of India Overseas Investment Corporation to acquire energy assets like fertilizers, oil and gas supplies ii different countries. The initiatives have already been taken to source oil from countries in Africa, and Malaysia and Venezuela and to diversify sourcing of crude oil.

VII. INFRASTRUCURE DEBT FUND

IDFs are investment vehicles which can be sponsored by commercial banks and NBFCs in India. IDFs would act as vehicles for refinancing debt of Infra companies, creating headroom for banks to lend to fresh projects. IDF-NBFCs would take over loans extended to infra projects which are created through the PPP route and have successfully completed one year of commercial production. Such a take-over of loans from banks would be covered by a Tripartite Agreement between the IDF,

Concessionaire and the Project Authority for ensuring a compulsory buyout with "termination payment in the event of default in repayment

IDFs can be set up either as a trust or as a company. A trust-based IDF would be a MF, regulated by SEBI; a company-based IDF would be a NBFC regulated by RBI. IDF-MFs can be sponsored by banks and NBFCs. Only banks and infra finance companies can sponsor IDF-NBFCs. Domestic/offshore institutional investors, insurance and pension funds can invest through units and bonds issued by the IDFs.

VIII. BITCOINS

Bitcoins are an electronic payment system done over the internet for services rendered or for donations or transactions. These Bitcoins are a mathematical number (based on some formula) and cannot be broken down or accessed by a third party (a thief on internet or a hacker, ideally). There are Currency Exchanges where these Bitcoins can be exchanged for Euros or Dollars. The currency exchanges are Mt Gox in Japan, btc China and in Eurozone. At present 1 Bitcoin is roughly close to 700 Dollars (US). There is also a cap on the maximum number of Bitcoins (21 million).

For example, if a payment in Bitcoins is done by a person 'A' to 'B', then a mathematical number signifying a certain amount of Bitcoins is generated by a 'Bitcoin Client' on 'A's computer system, and is accepted by 'B's 'Bitcoin Client' on 'B's computer system. These Bitcoin Clients are more like a protocol running on both systems. Once 'B' accepts the bitcoins, it may use it further to render a service, buy a service, donate or transact further.

'B' accepts the Bitcoins even though Bitcoins do not have any intrinsic value attached to them. Nowadays more and more merchants are accepting it every day. The question arises as to why would people use Bitcoins when they have access to Credit Cards/ RTGS/ Electronic Payment which are more mainstream and more acceptable? This is because of the following benefits which can be derived from the usage of Bitcoins:-

1. Privacy – People can transact in Bitcoins, without telling anyone or divulging who they are, on the internet. It's more like using cash as we do not have to give an ID or a proof while making cash purchase. Thus, Bitcoin transactions can be done anonymously. On the flip side, anonymous transfer of huge funds as bribes,

money laundering, illicit drug trade racket etc. may take place if Bitcoins gain legal currency everywhere.

2. Bitcoin is open – Anyone having an internet connection can make an internet transaction with Bitcoins. They just need to download and install the Bitcoin client on their computer system. A person wanting to initiate a transaction with Bitcoins needs to merely identify the recipient of the Bitcoins. The software (Bitcoin client) does the rest in an open manner. (As compared to a Credit Card transaction where your need a bank account, an Internet signing password, some pin code etc.) This means that people not having a bank account or a credit card can transact through Bitcoins. On the other hand, the elimination of the need of a central bank may have a negative effect in the form of reduced authenticity.

3. Decentralised system – It's a system without any bank or even a centralised bank. There is no third party controlling the money supply. An entity cannot seize Bitcoins (as they are not centralized). Reversing a Bitcoin transaction also depends on the two participants only ('A' and 'B'). Instead of taking hours for a settled transaction via Credit Card or RTGS, a Bitcoin transaction usually gets confirmed in less than 10 minutes. But, too much decentralisation may create a void where fraudulent activities are promoted.

Bitcoin mechanism

It is decentralised (based on peer-to-peer network). P2p networks are different computers connected to each other through networks. (E.g. internet, Ethernet, LAN, WAN etc.). Bitcoins are a form of crypto – currency, meaning that these are digital currencies used with certain specifications to implement a distributed, decentralized and secure information economy.

The Bitcoins are recorded in a public ledger which is maintained and broadcasted to every node (a computer system having the Bitcoin Client on the p2p network) by some nodes which are called Bitcoin Miners. These Miners validate the exchange of the Bitcoins in return for a fee (usually deducted from the transacted Bitcoin amount). This validation is done by applying a lot of mathematical formulas to the mathematical number (Bitcoins) and checking the veracity of the transaction. This is done by many Miners as the Ledger is open for everyone to view and even copy. The Bitcoin Miners record all the transactions and also their efforts of mining in a 'Block'. The efforts of

Bitcoin miners are called as 'Proof of work'. For Example 'A' has to pay 'B' some Bitcoins (let's say 30) and A has 50 Bitcoins. When 'A' makes the 30 Bitcoins payment to 'B' then, lets assume, 0.001 Bitcoin may be deducted as a transaction cost (to be paid to the single Miner or group of Miners validating the transaction), 30 Bitcoins will be credited to 'B' and 18.999 will be left in 'A's account. 'A' will put a 'digital signature' to the transaction which will be recorded in a 'Transaction Block'. Data miners will include a 'transaction cost' and a sequence of numbers called as 'Proof of work'. Each 'Transaction Block' contains a chain and it is broadcast to all the nodes on the person to person network. The 'chain of transaction block' which has the greatest amount of 'Proof of work' and is the longest will be worked upon by most of the Miners. Because longer the chain, larger the work to be done and fatter the transaction costs which can be credited to the data miners. Thus a weak 'transaction block chain' will die if it is not popular or if it is not being used by many. Only the most popular (signified by a long 'transaction block chain') will remain in currency.

Other Risks associated with Bitcoins

Virtual currencies like Bitcoins are yet to gain legitimacy and are prone to large fluctuations as they are purely dependent on sale and demand. It may also be prone to hacking, online theft, spamming, phishing and tracking. If virtual money buys real goods, then the value of real money may take a toll. Though it is too early to formulate opinion on the efficacy of Bitcoins as they ensure extraordinary safety and safeguards to their clients but they are yet to gain worldwide confidence among the citizens. Virtual currency has certain gaping loopholes which if removed, may lead to a paperless currency being used worldwide.

Some more facts about Bitcoins

1. Bitcoin price is volatile - Due to its young economy, novel nature and illiquid markets. It is a high risk asset.
2. Bitcoin payments are irreversible - They can only be refunded by the person receiving the funds. This means that you need to do business with people and organisations you know and trust.
3. Bitcoin transactions are stored publicly and permanently on the network.
4. A Bitcoin transaction is usually deployed within a few seconds and begins to be confirmed in the following 10 minutes.

5. Bitcoin is still experimental:- Its future cannot be predicted.
6. Bitcoin is not an official currency. Most jurisdictions still require you to pay income, sales, payroll and capital gain taxes or anything that has value, including Bitcoin.

   How people join/ start connecting to Bitcoin (people to people)

(a) Software wallets – Installed on computer.

(b) Mobile wallets – Using QR code or NFC

(c) Web wallets – Using anywhere as a host for Bitcoins

QR Code:- 'Quick Response Code' is a type of matrix Barcode

NFC:- 'Near Field Communication' is a short – range high frequency wireless communication technology used to transfer data over two different smart phones merely by touching them together.

Getting Bitcoins

(a) By accepting them as payment for goods and services.

(b) By buying them from a friend or someone near you.

(c) Buying from an exchange (like MtGox) with your bank account.

Legal and other Issues

1. Bitcoin has been a subject of scrutiny of FBI due to illicit activity. But US seems more friendly as compared to China, European Banks, India etc.
2. People's Bank of China prohibits Chinese financial institutions from using Bitcoins.
3. Former Federal Reserve Chairman Alan Greenspan has named Bitcoin as a bubble.
4. Bitcoins are being traded as investment by speculators who expect the currency value to gain as it becomes more popular.
5. 'Virgin Galactic' – A company belonging to Virgin group has invested in Bitcoin and is promoting it actively.
6. It is the currency of choice for speedy online activities.

7. It promotes black marketing of illegal drugs or substances owing to the anonymity associated with it.
8. There may be certain efforts to use Bitcoins to launder money but owing to its public ledger and public transaction block chain it may not be possible to use Bitcoin to launder money.

IX. REPORT OF KELKAR PANEL ON FUNDING FOR PPP PROJECTS

A government appointed committee on reviving PPP model headed by Vijay Kelkar submitted its report in November, 2015. The Committee has suggested ensuring easier funding for projects with long gestation period and early action to amend the Prevention of Corruption Act 1986 to guard them against a witch hunt.

Listing out a slew of measures to revive PPP model, the committee, headed by Vijay Kelkar, former finance secretary, said that the government should encourage development of infrastructure sectors including airports, ports and railways under the PPP mode by ensuring easier funding. It also recommended review of model concession agreements, raising of funds through zero coupon bonds and setting up of independent regulators.

The government may take early action to amend the Prevention of Corruption Act, 1988 which does not distinguish between genuine errors in decision-making and acts of corruption. Measures may be taken immediately to make only malafide action by public servants punishable, and not errors and to guard against witch hunt against government officers and bureaucrats for decisions taken with bonafide intention.

Further, emphasising on the need to strengthen governance, institutions and capacity, the committee said that the government should notify comprehensive guidelines on applicability and scope of government audit and access under the RTI to address concerns of stakeholders.

There have been concerns raised by all stakeholders (government and private sector alike) on the demand for developer books of account being subjected to government audit and for access under RTI and Article 12 of Constitution. To address this, the committee recommends that the government notify comprehensive guidelines

... enable review only to government internal systems, and not that of SPVs, but SPVs would need to follow best practices in corporate governance system.

With regard to stalled PPP projects, the committee said it needs to be kick started, there is an urgent need to evolve a suitable mechanism that evaluates and addresses actionable stress. Sector specific institutional frameworks should be developed to address these stalled infrastructure projects.

Seeking better identification and allocations of risks, the report said that the government should move the PPP model to the next level of maturity and sophistication and "foster trust between private sector and public sector partners in implementing the PPP projects".

The other suggestions include restrictions on number of banks in a consortium, building up of risk assessment and appraisal capabilities by banks and specific RBI guidelines to lenders for encashment of bank guarantees.